

IV

GOVERNMENT FINANCES

4.1 Government finances witnessed some improvement in 2003-04, reflecting the robust macroeconomic performance and the commitment towards sustainable fiscal consolidation. All the key deficit indicators, *viz.*, gross fiscal deficit (GFD), revenue deficit (RD) and primary deficit (PD) of the Centre in the revised estimates as well as in the provisional accounts for 2003-04 turned out to be lower than their budgeted levels, facilitated by higher revenue realisation and containment of non-Plan expenditure. In particular, the spectacular growth in corporation tax collections on the back of the rising profitability of the corporate sector enabled a rise in the tax-GDP ratio after seven years. Furthermore, proceeds from disinvestments exceeded the budgeted target after a gap of four years. On the other hand, there was an erosion in the health of State finances with all the key deficit indicators rising in the revised estimates for 2003-04 on account of the large increase in expenditure.

4.2 The review of Government finances in 2003-04 presented in this Section covers fiscal operations of the Centre, the States and the combined government (Centre and States) finances. The Section undertakes an assessment of the improvement in Central finances. It analyses the factors underlying deterioration in State finances - stagnancy in States' own revenue and a large increase in expenditure *albeit* accompanied by rising development expenditure. The debt position and contingent liabilities of the Centre and the States are also reviewed with details on debt management covered in Part Two of this Report.

4.3 An overview of the combined finances of the Centre and the States shows an improvement in 2003-04 on account of a lower growth in aggregate expenditure *vis-à-vis* non-debt receipts. The combined tax-GDP ratio increased by 0.5 percentage points over the previous year's level, with the improvement in direct taxes being more pronounced. On the expenditure front, there was a qualitative improvement in 2003-04 as reflected in a shift in favour of the developmental component. The softening of interest rates enabled by monetary policy, coupled with buoyant revenue receipts, resulted in a decline in the ratio of interest payments to revenue receipts (Table 4.1).

Table 4.1: Indicators of Fiscal Policy

| Item | 2003-04 RE | 2002-03 | 1995-96 | 1990-91 |
|--|------------|---------|---------|---------|
| 1 | 2 | 3 | 4 | 5 |
| (Per cent of GDP) | | | | |
| Gross Fiscal Deficit | 9.4 | 9.5 | 6.5 | 9.4 |
| Revenue Deficit | 6.2 | 6.6 | 3.2 | 4.2 |
| Primary Deficit | 2.9 | 3.1 | 1.6 | 5.0 |
| Revenue Receipts | 19.1 | 18.2 | 18.3 | 18.6 |
| Tax Revenue | 15.0 | 14.5 | 14.7 | 15.4 |
| Direct Taxes | 4.4 | 4.1 | 3.5 | 2.5 |
| Indirect Taxes | 10.6 | 10.4 | 11.2 | 12.9 |
| Non-tax Revenue | 4.1 | 3.7 | 3.6 | 3.2 |
| Total Expenditure | 31.9 | 29.4 | 25.6 | 28.8 |
| Developmental Expenditure | 15.9 | 14.5 | 13.9 | 17.4 |
| Non-developmental Expenditure | 14.4* | 14.4* | 11.6 | 11.4 |
| Interest Payments | 6.5 | 6.4 | 5.0 | 4.4 |
| Debt | 76.7 | 75.9 | 58.0 | 61.7 |
| (Per cent) | | | | |
| Capital Outlay/ Total Expenditure | 11.0 | 9.0 | 10.7 | 13.1 |
| Interest Payments/ Revenue Receipts | 34.0 | 35.2 | 27.2 | 23.6 |
| Revenue Deficit/GFD | 66.1 | 69.4 | 48.8 | 44.6 |

RE : Revised Estimates.

* : Excluding repayments to NSSF.

Note: 1. All indicators are based on combined data of the Centre and the States with inter-Governmental transactions netted out.

2. Data in respect of the State Governments are provisional for the years 2002-03 and 2003-04 and relate to the Budgets of 27 State Governments, of which six are Vote on Account.

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Revised Estimates

4.4 During 2003-04, finances of the Central Government revealed an improvement in the revised estimates *vis-à-vis* the budget estimates. This paved the way for the implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. The key deficit indicators, *viz.*, gross fiscal deficit, revenue deficit and primary deficit in 2003-04 were lower in comparison with the budget estimates as well as their levels in 2002-03. In 2003-04, the GFD and the PD were at their lowest level since 1990-91 in relation to GDP. More than half of the reduction in the gross fiscal deficit was due to the improvement in the revenue account (Table 4.2).

4.5 The improved fiscal performance during 2003-04 was also attributable to a successful strategy

Table 4.2: Gross Fiscal Deficit – Budget *vis-à-vis* Revised Estimates

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | Variation RE over BE |
|---|-----------------|-----------------|-------------------------|
| 1 | 2 | 3 | 4 |
| Gross Fiscal Deficit (3+4+5+6-1-2) | 1,32,103 | 1,53,637 | -21,534 |
| 1. Revenue Receipts | 2,63,027 | 2,53,935 | 9,092 |
| 2. Disinvestment | 14,500 | 13,200 | 1,300 |
| 3. Revenue Expenditure | 3,62,887 | 3,66,227 | -3,340 |
| 4. Capital Outlay | 36,273 | 42,283 | -6,010 |
| <i>of which:</i> | | | |
| Defence | 16,906 | 20,953 | -4,047 |
| 5. Public Debt Repayment# | 46,602 | – | 46,602 |
| 6. Net Lending | -36,132 | 12,262 | -48,394 @ |

RE : Revised Estimates.

BE: Budget Estimates.

: Reflects expenditure on account of repayments to the NSSF met from recoveries under debt swap scheme.

@ : Net lending is negative on account of increase in recovery of loans from the States under the debt swap scheme.

for containing non-Plan expenditure. The decline in interest rates on fresh borrowings in recent years

facilitated a reduction in the ratio of interest payments to revenue receipts. In addition, higher disinvestment proceeds also enabled fiscal consolidation. The Centre built up a cash surplus with the Reserve Bank from August 2003, which was generally invested in its own paper. The trend in cut back in capital outlay, however, persisted in 2003-04.

4.6 A sharp decline in net lending was on account of increased recovery of loans from the State Governments amounting to Rs.46,602 crore under the Debt Swap Scheme (DSS), which was utilised for discharge of liabilities to the National Small Savings Fund (NSSF). The utilisation of the debt swap receipts for discharging liabilities to the NSSF made the debt swap GFD neutral (Box IV.1).

Centre's Revenues

4.7 Buoyant economic activity led to an improvement in the ratio of revenue receipts to GDP. The increase in gross tax revenue was on account of

Box IV.1 Debt Swap Scheme

The Union Budget for 2003-04 announced a Debt Swap Scheme to enable the State Governments to substitute their high-cost loans from the Centre with fresh market borrowings and a portion of small saving transfers (100 per cent of the net small savings collections are being transferred to the States from 2002-03 onwards). Under the DSS, the States swapped high cost loans (bearing coupons in excess of 13 per cent) amounting to Rs.13,766 crore during 2002-03 with additional market borrowings of Rs.10,000 crore and the remaining through small saving transfers. During 2003-04, as per revised estimates the States swapped Rs.46,602 crore with additional market borrowings of Rs.26,623 crore (as per RBI records) and 30 per cent of the small saving transfers. Thus, of the total debt swapped amounting to Rs.60,400 crore, about 61 per cent was financed through additional market borrowings at interest rates below 6.5 per cent and the remaining through issue of special securities to the National Small Savings Fund (NSSF) with the interest rate fixed at 9.5 per cent. As per the Union Budget for 2004-05, recoveries from the States include a sum of Rs.11,000 crore under the DSS for the current fiscal year. The receipts under the DSS were used by the Central Government to partially redeem the special securities issued to the NSSF at the time of its inception in 1999. The NSSF, in turn, reinvested the funds in fresh Central Government special securities in 2003-04 at market-related interest rates.

According to the accounting arrangement in the Union Budget, recoveries of loans from the States under the DSS lead to an increase in non-debt capital receipts, while Centre's repayment to the NSSF results in an increase in the non-

plan capital expenditure. Since both the receipts and expenditure increase by the same magnitude, the DSS is GFD neutral. However, the DSS results in a change in the composition of financing of Centre's GFD since the NSSF's reinvestment in the Central Government Special Securities reduces the financing need from other sources, including market borrowings.

For the States, the DSS is, *ipso facto*, debt neutral as it involves swapping one form of debt with another. In the States' Budgets, repayment of loans to the Centre reduces the debt of the States. However, as this repayment is made out of additional market borrowings and small saving transfers, it increases the debt from these sources by an equal magnitude. The DSS, however, does not have any effect on the magnitude of the fiscal deficit since by definition, borrowings for the purpose of repayment as well as repayments made out of such borrowings are not included in the calculation of the GFD. As in the case of the Centre, the DSS alters the composition of financing of States' GFD. While (net) market borrowings increase, (net) loans from the Centre register a decline. Over a period of time, savings in the form of lower interest payments would reduce the pressure on the revenue account of the States and thereby reduce their borrowing requirement.

References

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2. Government of India (2004), *Union Budget, 2004-05*.
3. Reserve Bank of India (2004), *State Finances - A Study of Budgets of 2003-04*.

increased collections under corporation tax and service tax, which mitigated the shortfall in receipts under personal income tax and union excise duty. The considerable growth in service tax realisation resulted from measures aimed at bringing more services under the tax net (Box IV.2).

4.8 The rationalisation of direct taxes as a part of the ongoing reforms and the resultant improvement in tax compliance facilitated a rise in the share of direct taxes in total tax revenue. On the other hand, the share of indirect taxes came down from more than 80 per cent in 1990-91 to less than 60 per cent during 2003-04.

4.9 As per the revised estimates, non-tax revenue increased by 8.2 per cent over the budget estimates mainly due to higher dividends and profits (Table 4.3). Interest receipts were, however, lower in the revised estimates than the budgeted level, reflecting the impact of the DSS.

4.10 Capital receipts of the Central Government were also higher than the budget estimates on account of higher receipts under the DSS and proceeds from disinvestment (Table 4.4). Disinvestment proceeds exceeded the budgetary target after a gap of four years (Chart IV.1).

Centre's Expenditure

4.11 The total expenditure in the revised estimates for 2003-04 was higher than the budgeted level mainly due to the discharge of liabilities to the NSSF by the Centre (Table 4.5). Excluding the Centre's repayments to the NSSF, aggregate expenditure, however, was lower than the budgeted level. The reduction in expenditure was recorded both in the revenue account and in the capital account (net of NSSF repayments).

4.12 The lower revenue expenditure in the revised estimates was largely on account of a reduction in

Box IV.2

Taxation of Services

The objectives of levying a service tax are: (i) shrinking of the tax base as the share of industry in GDP decreases while that of services expands; (ii) failure to tax services distorts consumer choices and encourages spending on services at the expense of goods; (iii) untaxed service traders are unable to claim VAT on service inputs, which encourages businesses to develop in-house services, creating further distortions; and (iv) most of the services that are likely to become taxable are positively correlated with expenditure of high-income households and, therefore, service tax improves equity.

In the Indian context, taxation of services assumes importance in the wake of the need for improving the revenue system, ensuring a measure of neutrality in taxation between goods and services and eventually helping to evolve an efficient system of domestic trade taxes, both at the Central and the State levels. The service tax was levied in India on the basis of the recommendations made by the Tax Reforms Committee (Chairman: Dr. Raja Chelliah), the provisions of which were brought into force with effect from July 1, 1994. The coverage has progressively widened over the years. At present, service tax is levied on 58 items. The Union Budget, 2004-05 proposes to extend the service tax to 13 additional services. The service tax is applicable to all parts of India except the State of Jammu and Kashmir and is leviable on the gross amount charged by the service provider from the client. The rate of service tax has been increased from 5 per cent to 8 per cent on all the taxable services with effect from May 14, 2003. The Union Budget, 2004-05 proposes to increase the service tax rate to 10 per cent.

Collections from the service tax have shown a steady rise from Rs.410 crore in 1994-95 to Rs.8,300 crore in 2003-04 (RE); however, they accounted for only 4.4 per cent of the total tax receipts of the Centre (0.3 per cent of GDP) in 2003-04.

The service tax is envisaged as the tax of the future. The inclusion of all value added services in the tax net would yield a larger amount of revenue and make the existing tax structure more elastic. The increase in the share of the services sector in GDP holds the key to larger revenue generation.

References

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Table 4.3 : Total Receipts of the Centre

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 1995-96 | 1990-91 | Variation RE over BE (2003-04) | |
|--|--------------------|--------------------|--------------------|--------------------|------------------|-----------------------------------|----------|
| | | | | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Total Receipts (A+B) | 4,74,255 (17.1) | 4,38,795 (16.0) | 4,14,162 (16.8) | 1,68,468 (14.2) | 93,951 (16.5) | 35,460 | 8.1 |
| A. Revenue Receipts (a+b) | 2,63,027 (9.5) | 2,53,935 (9.3) | 2,31,748 (9.4) | 1,10,130 (9.3) | 54,954 (9.7) | 9,092 | 3.6 |
| a. Tax Revenue (Net) | 1,87,539 (6.8) | 1,84,169 (6.7) | 1,59,425 (6.5) | 81,939 (6.9) | 42,978 (7.6) | 3,370 | 1.8 |
| b. Non-tax Revenue | 75,488 (2.7) | 69,766 (2.5) | 72,323 (2.9) | 28,191 (2.4) | 11,976 (2.1) | 5,722 | 8.2 |
| B. Capital Receipts | 2,11,228 (7.6) | 1,84,860 (6.7) | 1,82,414 (7.4) | 58,338 (4.9) | 38,997 (6.9) | 26,368 | 14.3 |
| <i>Memo Items@:</i> | | | | | | | |
| Gross Tax Revenue | 2,54,923 | 2,51,527 (9.2) | 2,16,266 (9.2) | 1,11,224 (8.8) | 57,576 (9.4) | 3,396 (10.1) | 1.4 |
| Corporation Tax | 62,986 | 51,499 (2.3) | 46,172 (1.9) | 16,487 (1.9) | 5,335 (1.4) | 11,487 (0.9) | 22.3 |
| Income Tax | 40,269 | 44,070 (1.5) | 36,858 (1.6) | 15,592 (1.5) | 5,371 (1.3) | -3,801 (0.9) | -8.6 |
| Customs Duty | 49,350 | 49,350 (1.8) | 44,852 (1.8) | 35,757 (1.8) | 20,644 (3.0) | 0 (3.6) | 0.0 |
| Union Excise Duty | 92,379 | 96,791 (3.3) | 82,310 (3.5) | 40,187 (3.3) | 24,514 (3.4) | -4,412 (4.3) | -4.6 |
| Service Tax | 8,300 | 8,000 (0.3) | 4,122 (0.3) | 862 (0.2) | - (0.1) | 300 | 3.8 |
| RE : Revised Estimates. BE : Budget Estimates. @ : These items are on a gross basis, i.e., including the States' share. Notes : 1. Figures in parentheses are percentages to GDP. 2. Service tax was introduced from 1994-95. | | | | | | | |

subsidies (Rs.5,198 crore) and non-Plan grants to the States and the Union Territories (Rs.2,700 crore) from the budgeted levels (Table 4.5). Interest payments

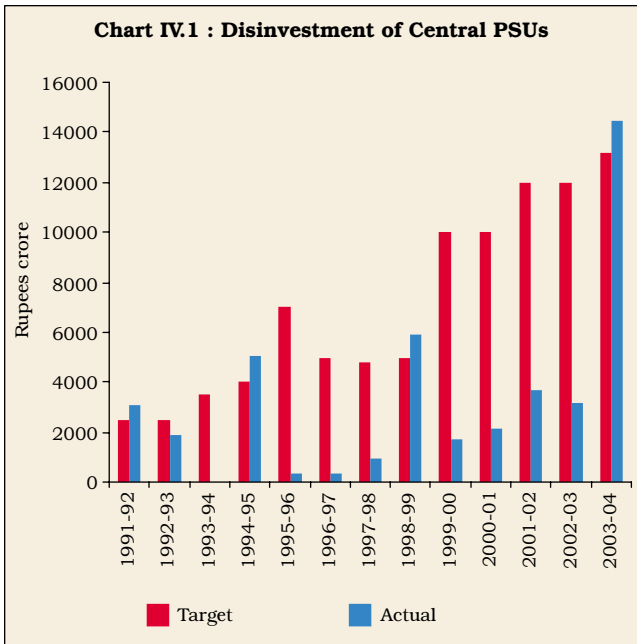
(including prepayment premium of Rs.4,080 crore on internal and external debt) were higher than in the budget estimates. Excluding the premium amount,

Table 4.4: Capital Receipts of the Centre

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 1995-96 | 1990-91 | Variation RE over BE (2003-04) | |
|---|-------------------|-------------------|-------------------|-----------------|-----------------|-----------------------------------|----------|
| | | | | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Capital Receipts | 2,11,228 (7.7) | 1,84,860 (6.7) | 1,82,414 (7.4) | 58,338 (4.9) | 38,997 (6.9) | 26,368 | 14.3 |
| Non-debt Capital Receipts | 79,125 (2.9) | 31,223 (1.1) | 37,342 (1.5) | 6,867 (0.6) | 5,712 (1.0) | 47,902 | 153.4 |
| Debt Capital Receipts | 1,32,103 (4.8) | 1,53,637 (5.6) | 1,45,072 (5.9) | 51,471 (4.3) | 33,285 (5.9) | -21,534 | -14.0 |
| <i>Memo Items :</i> | | | | | | | |
| Capital receipts excluding receipts on account of debt swap scheme | | | | | | | |
| Total Capital Receipts | 1,64,626 (5.9) | 1,68,648 (6.8) | | | | | |
| Non-debt Capital Receipts | 32,523 (1.2) | 23,576 (1.0) | | | | | |
| RE : Revised Estimates. BE : Budget Estimates. Note : Figures in parentheses are percentages to GDP. | | | | | | | |

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interest payments showed a decline of Rs.2,748 crore from the budgeted level.

4.13 Capital expenditure (net of NSSF repayments) was lower than in the budget estimates, with both the capital outlay and loans and advances declining over the budgeted levels (Table 4.6).

4.14 An analysis of aggregate expenditure (net of transactions relating to the debt swap scheme) shows that the reduction was effected exclusively in the non-Plan component. This comprised a reduction of Rs.4,583 crore in the revenue account and Rs.7,092 crore in the capital account on account of cutbacks in expenditure on subsidies and grants to the States and the Union Territories, as alluded to earlier, and reduction in defence expenditure (Table 4.7).

Financing Pattern of Gross Fiscal Deficit

4.15 The financing pattern of the GFD in the revised estimates *vis-à-vis* the budget estimates underwent a compositional shift on account of the DSS. The surplus cash balances emanating therefrom economised on the requirement of financing the GFD (Table 4.8). While the share of market borrowings was lower than the budget estimates, securities issued to the NSSF accounted for 45.7 per cent of the GFD.

Provisional Accounts

4.16 The financial position of the Central Government as revealed by the provisional accounts for 2003-04 showed an improvement in terms of all the key deficit indicators over the revised estimates (Table 4.9) .

Table 4.5: Aggregate Expenditure of the Centre

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 1995-96 | 1990-91 | Variation RE over BE (2003-04) | |
|---|--------------------|--------------------|--------------------|--------------------|-------------------|-----------------------------------|----------|
| | | | | | | Absolute | Per cent |
| | | | | | | 7 | 8 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| 1. Revenue Expenditure | 3,62,887 (13.1) | 3,66,227 (13.3) | 3,39,627 (13.8) | 1,39,861 (11.8) | 73,516 (12.9) | -3,340 | -0.9 |
| 2. Capital Expenditure | 1,11,368 (4.0) | 72,568 (2.6) | 74,535 (3.0) | 38,414 (3.2) | 31,782 (5.6) | 38,800 | 53.5 |
| 3. Total Expenditure (1+2) | 4,74,255 (17.1) | 4,38,795 (16.0) | 4,14,162 (16.8) | 1,78,275 (15.0) | 105,298 (18.5) | 35,460 | 8.1 |
| <i>Memo Items :</i> | | | | | | | |
| Expenditure Net of Repayments to the NSSF | | | | | | | |
| Capital Expenditure | 64,766 (2.3) | | 60,769 (2.5) | | | | |
| Total Expenditure | 4,27,653 (15.4) | | 4,00,396 (16.2) | | | | |

RE : Revised Estimates. BE : Budget Estimates.
Note : Figures in parentheses are percentages to GDP.

Table 4.6: Capital Expenditure of the Centre

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 1995-96 | 1990-91 | Variation RE over BE (2003-04) | |
|--|-----------------|-----------------|----------|---------|---------|-----------------------------------|----------|
| | | | | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Total Capital Expenditure (a+b=I+II) | 64,766 * | 72,568 | 60,769 * | 38,414 | 31,782 | -7,802 | -10.8 |
| | (2.3) | (2.6) | (2.5) | (3.2) | (5.6) | | |
| a. Capital Outlay | 36,273 | 42,283 | 29,101 | 14,099 | 12,130 | -6,010 | -14.2 |
| | (1.3) | (1.5) | (1.2) | (1.2) | (2.1) | | |
| b. Loans and Advances | 28,493 | 30,285 | 31,668 | 24,316 | 19,652 | -1,792 | -5.9 |
| | (1.0) | (1.1) | (1.3) | (2.0) | (3.5) | | |
| I. Non-Plan Capital Expenditure | 21,345 | 28,437 | 20,868 | 21,062 | 15,348 | -7,092 | -24.9 |
| | (0.8) | (1.0) | (0.8) | (1.8) | (2.7) | | |
| <i>of which:</i> | | | | | | | |
| Defence Capital | 16,906 | 20,953 | 14,953 | 8,015 | 4,552 | -4,047 | -19.3 |
| | (0.6) | (0.8) | (0.6) | (0.7) | (0.8) | | |
| II. Plan Capital Expenditure | 43,421 | 44,131 | 39,901 | 17,353 | 15,745 | -710 | -1.6 |
| | (1.6) | (1.6) | (1.6) | (1.5) | (2.8) | | |
| i) Central Plan Outlay | 20,089 | 20,028 | 17,880 | 8,255 | 9,134 | 61 | 0.3 |
| | (0.7) | (0.7) | (0.7) | (0.7) | (1.6) | | |
| ii) Central Assistance for State and UT Plans | 23,332 | 24,103 | 22,021 | 9,098 | 6,611 | -771 | -3.2 |
| | (0.8) | (0.9) | (0.9) | (0.8) | (1.2) | | |

RE : Revised Estimates. BE : Budget Estimates. * : Net of repayments to the NSSF.

Note : Figures in parentheses are percentages to GDP.

4.17 In relation to GDP, the revenue deficit and the gross fiscal deficit were lower by 0.9 percentage points and 1.4 percentage points, respectively, than in 2002-03. The reduction in the revenue deficit was mainly on account of a decline in non-interest revenue expenditure, particularly in defence, subsidies and

non-Plan grants to the States. The decline in the GFD was attributable to the lower revenue deficit and higher disinvestment proceeds. The gross primary deficit to GDP, which was 0.5 per cent in 2002-03, declined to 0.1 per cent in 2003-04, primarily on account of lower non-interest revenue expenditure.

Table 4.7: Non-Plan Expenditure of the Centre

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 1995-96 | 1990-91 | Variation RE over BE (2003-04) | |
|----------------------|-----------------|-----------------|------------|----------|---------|-----------------------------------|----------|
| | | | | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Non-Plan Expenditure | 3,06,146 * | 3,17,821 | 2,88,943 * | 1,31,901 | 76,933 | -11,675 | -3.7 |
| | (11.0) | (11.6) | (11.7) | (11.1) | (13.5) | | |
| <i>Of which:</i> | | | | | | | |
| Interest Payments | 1,24,555 # | 1,23,223 | 1,17,804 | 50,045 | 21,498 | 1,332 | 1.1 |
| | (4.5) | (4.5) | (4.8) | (4.2) | (3.8) | | |
| Defence | 60,300 | 65,300 | 55,662 | 26,856 | 15,426 | -5,000 | -7.7 |
| | (2.2) | (2.4) | (2.3) | (2.3) | (2.7) | | |
| Subsidies | 44,709 | 49,907 | 43,515 | 12,666 | 12,158 | -5,198 | -10.4 |
| | (1.6) | (1.8) | (1.8) | (1.1) | (2.1) | | |

RE : Revised Estimates. BE : Budget Estimates.

* : Net of repayments to the NSSF.

: Including prepayment premium of Rs.4,080 crore for reduction of debt.

Note : Figures in parentheses are percentages to GDP.

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Table 4.8: Financing of Gross Fiscal Deficit of the Centre

(Rupees crore)

| Item | 2003-04 RE | 2003-04 BE | 2002-03 | 1995-96 | 1990-91 |
|--|-------------------|--------------------|--------------------|--------------------|-------------------|
| 1 | 2 | 3 | 4 | 5 | 6 |
| Gross Fiscal Deficit | 1,32,103 | 1,53,637 | 1,45,072 | 60,243 | 44,632 |
| <i>Financed by:</i> | | | | | |
| Market Borrowings* | 85,671 (64.9) | 1,07,194 (69.8) | 1,04,126 (71.8) | 34,001 (55.6) | 8,001 (17.9) |
| State Provident Funds | 5,000 (3.8) | 7,500 (4.9) | 4,621 (3.2) | 2,261 (3.7) | 1,221 (2.7) |
| NSSF Investment in Central Government Special Securities | 60,400 (45.7) | 0 (0.0) | 0 (0.0) | 12,761 + (20.9) | 9,104 + (20.4) |
| Special Deposits | -451 # (-0.3) | 9,970 (6.5) | 11,468 (7.9) | 5,295 (8.7) | 7,716 (17.3) |
| External Assistance | -11,705 (-8.9) | 3,582 (2.3) | -11,934 (-8.2) | 318 (0.5) | 3,181 (7.1) |
| Drawdown of Cash Balances | -10,232 (-7.7) | 0 (0.0) | 1,883 (1.3) | 9,807 (16.0) | 11,347 (25.4) |
| Others@ | 3,420 (2.6) | 25,391 (16.5) | 34,908 (24.1) | -4,200 (-7.0) | 4,062 (9.1) |

RE : Revised Estimates.

BE : Budget Estimates.

* : Comprising dated securities and 364-day Treasury Bills.

+ : Represents small saving collections.

: Reduction in receipts is on account of freezing of the corpus of special deposits as on June 30, 2003 and providing interest payment in cash on net balances.

@ : Includes saving bonds, reserve funds, deposits, postal insurance, life annuity funds and special securities issued to international financial institutions.

Note : Figures in parentheses are percentages to GFD

Table 4.9: Variations between the Budget Estimates, Revised Estimates and Provisional Accounts for 2003-04

(Per cent)

| Deficit Indicators | RE over BE | ProA over RE | ProA over BE |
|-----------------------|------------|--------------|--------------|
| 1 | 2 | 3 | 4 |
| Revenue Deficit | -11.1 | -1.6 | -12.5 |
| Gross Fiscal Deficit | -14.0 | -4.7 | -18.0 |
| Gross Primary Deficit | -75.2 | -77.5 | -94.4 |

RE : Revised Estimates.

BE : Budget Estimates.

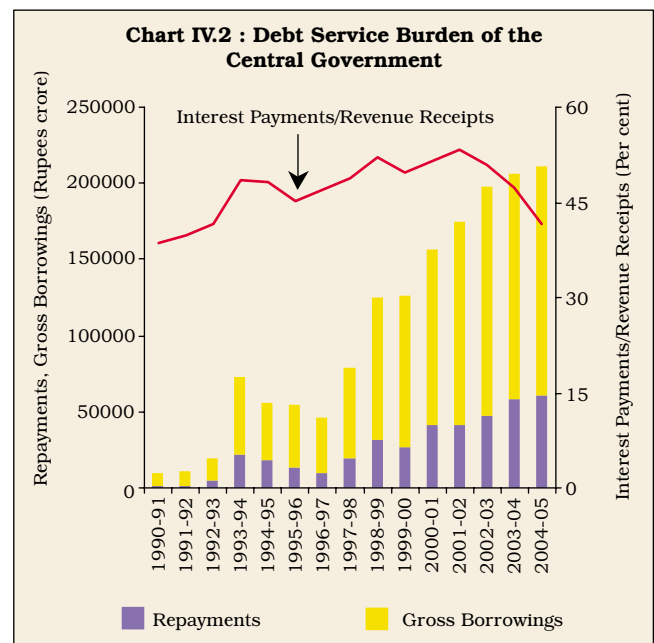
ProA: Provisional Accounts (unaudited) as released by the Controller General of Accounts.

Debt Position of the Central Government

4.18 The outstanding domestic liabilities of the Central Government declined marginally to 60.5 per cent of GDP at end-March 2004 from 60.7 per cent at the end of the preceding fiscal year. Internal debt alone accounted for 65.8 per cent of the total outstanding debt of the Central Government, while 'other liabilities' which comprise, *inter alia*, small savings and provident funds accounted for 31.5 per cent.

4.19 The high debt-GDP ratio has resulted in a large debt service burden, both in terms of repayments and interest payments. Despite the elongation of the average maturity of dated securities in recent years, the proportion of repayments to gross market borrowings continued to be high at 39.8 per cent in 2003-04 as compared with the average of 31.5 per cent

during the period 1998-99 to 2002-03. During 2004-05, repayments as a percentage of gross market borrowings are estimated at 40.1 per cent. Although the buoyancy in revenue receipts and the sharp decline in interest rates in the recent past enabled a decline in the proportion of interest payments to revenue receipts from 53.4 per cent in 2001-02 to 47.4 per cent in 2003-04, it continues to remain high at 41.9 per cent in 2004-05 (Chart IV.2).



Interest Rate Structure of Central Government Debt

4.20 The soft interest rate regime has facilitated the raising of resources at relatively low cost. In recent years, the weighted average interest rate on the Centre's market borrowings by way of dated securities has declined steadily (Table 4.10). The cost of resources mobilised through small savings and provident funds has also declined as a consequence of the efforts to align interest rates on various small saving instruments with the market interest rates. For instance, interest rates on Public Provident Funds and National Saving Certificates were reduced from 12.0 per cent in 1999 to eight per cent in 2003. The effective cost to the Government in respect of non-marketable borrowings such as small savings and provident funds would, however, be higher if various tax exemptions available on these instruments are taken into account.

Contingent Liabilities/Guarantees of the Government

4.21 The growing size of contingent liabilities has implications for the sustainability of Government finances. The rising trend in guarantees extended by the Central and the State Governments has, however, moderated since end-March 2001 (Table 4.11).

Table 4.10: Average Interest Rates on Outstanding Domestic Liabilities of the Centre#

(Per cent)

| Year | Market Loans | Small Savings | Provident Funds | Special Deposits |
|------------|--------------|---------------|-----------------|------------------|
| 1 | 3 | 4 | 5 | 6 |
| 1991-92 | 10.43 | 9.95 | 11.76 | 15.31 |
| 1992-93 | 10.44 | 9.48 | 11.80 | 14.79 |
| 1993-94 | 11.33 | 12.21 | 11.69 | 14.35 |
| 1994-95 | 11.94 | 13.20 | 11.34 | 14.86 |
| 1995-96 | 11.76 | 11.33 | 11.18 | 15.23 |
| 1996-97 | 11.70 | 13.03 | 10.74 | 15.59 |
| 1997-98 | 12.05 | 11.92 | 12.48 | 15.08 |
| 1998-99 | 13.09 | 10.34 | 11.93 | 14.05 |
| 1999-00 | 13.34 | 11.50 | 11.80 | 15.46 |
| 2000-01 | 12.99 | 11.60 | 10.54 | 13.01 |
| 2001-02 | 12.83 | 11.61 | 9.09 | 13.73 |
| 2002-03 | 10.69 | 11.61 | 8.27 | 9.00 |
| 2003-04 RE | 9.86 | 10.88 | 7.66 | 8.22 |

: The interest rate for each component is computed by dividing the interest payments in a year by the outstanding liabilities at the end of the preceding year.

RE: Revised Estimates.

Note : 1. Small savings represent small saving deposits, certificates and public provident fund.
2. Since 1999-2000, interest on small savings represents interest on Central Government Special Securities issued to the NSSF.
3. The Government has notified the freezing of the *corpus* of Special Deposit Scheme as on June 30, 2003.

Table 4.11: Outstanding Government Guarantees

(Amount in Rs. crore)

| End-March | Centre | | States | | Total | |
|-----------|--------|-----------------|------------|-----------------|----------|-----------------|
| | Amount | Per cent of GDP | Amount | Per cent of GDP | Amount | Per cent of GDP |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 1993 | 58,088 | 7.8 | 42,515 | 5.7 | 1,00,603 | 13.4 |
| 1994 | 62,834 | 7.3 | 48,866 | 5.7 | 1,11,700 | 13.0 |
| 1995 | 62,468 | 6.2 | 48,479 | 4.8 | 1,10,947 | 11.0 |
| 1996 | 65,573 | 5.5 | 52,631 | 4.4 | 1,18,204 | 9.6 |
| 1997 | 69,748 | 5.1 | 63,409 | 4.6 | 1,33,157 | 9.7 |
| 1998 | 73,877 | 4.9 | 73,751 | 4.8 | 1,47,628 | 9.7 |
| 1999 | 74,606 | 4.3 | 97,454 | 5.6 | 1,72,060 | 9.9 |
| 2000 | 83,954 | 4.3 | 1,32,029 | 6.8 | 2,15,983 | 11.2 |
| 2001 | 86,862 | 4.1 | 1,68,719 | 8.1 | 2,55,581 | 12.2 |
| 2002 | 95,859 | 4.2 | 1,65,386 | 7.2 | 2,61,245 | 11.4 |
| 2003 | 90,617 | 3.7 | 1,84,294 P | 7.5 | 2,74,911 | 11.2 |

P : Provisional.

Note : Ratios to GDP may not add up to the total due to rounding off.

Source : 1. Data on Centre's guarantees are from budget documents of the Central Government.

2. Data on States' guarantees are based on the information received from the State Governments and pertain to 17 States.

STATE GOVERNMENT FINANCES – 2003-04¹

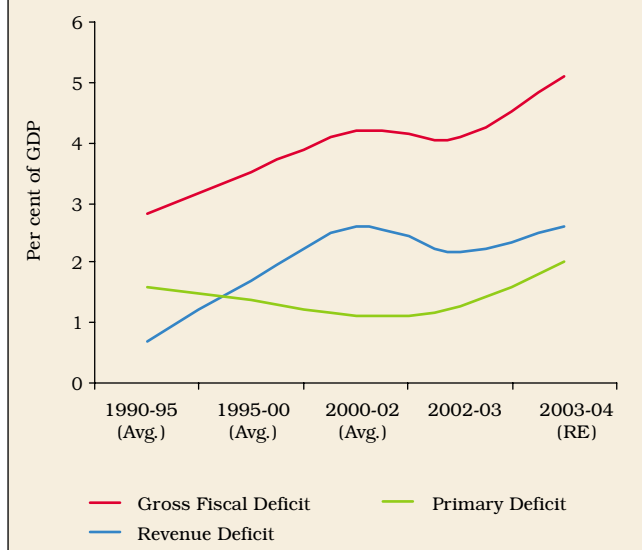
4.22 In recent years, the stress on the finances of the State Governments has intensified, as reflected in persistent and growing fiscal imbalances. The secular deterioration in State finances has impacted their current and prospective developmental and welfare-oriented functions. In this *milieu*, a positive development has been the growing recognition of the urgent need for fiscal consolidation. A number of State Governments initiated a wide spectrum of reforms in the late 1990s in order to arrest the deterioration in their financial position. These reforms have encompassed strengthening of tax efforts, rationalisation of user charges on public services, power sector reforms, expenditure management, ceilings on guarantees and, more recently, the enactment of fiscal responsibility legislation. The Central Government has also initiated measures to encourage and facilitate fiscal reforms at the State level.

4.23 Notwithstanding such initiatives, the emerging fiscal scenario as reflected in the revised estimates for 2003-04, indicates the persistence of structural infirmities in State finances, *albeit* with some improvement in the orientation of expenditure. This underscores the need to carry forward and reinvigorate the multi-pronged reform process at the State level.

4.24 All the major deficit indicators recorded substantial slippages from the budget estimates of 2003-04 and were placed higher than their respective levels in

¹ The analysis of State finances for 2004-05 is based on the budget documents of 27 State Governments of which 6 are Vote on Account. All data are provisional.

Chart IV.3 : Trends in Major Deficit Indicators of the State Governments



the past (Chart IV.3). The widening of the revenue deficit in 2003-04 mainly reflected the increased outgo on economic services and interest payments, offset to some extent by a rise in shareable tax revenue from the Centre.

4.25 Higher provisions for capital outlay on economic services in conjunction with the increase in the revenue deficit translated into an upsurge in the net borrowing requirement (GFD). The GFD-GDP ratio was placed higher at 5.1 per cent during 2003-04. While the revenue deficit continued to pre-empt more than half of the net borrowings in 2003-04, the share of capital outlay in GFD increased sharply over the level of the previous year.

4.26 The financing pattern of the GFD shows that small savings continue to account for the predominant share. The share of market borrowings in GFD, however, shows a sharp increase reflecting, *inter alia*, additional allocations under the DSS. As a consequence, repayments of loans to the Centre exceeded gross loans from the Centre during 2003-04.

4.27 According to the Reserve Bank's records, net market borrowings allocated to the States for the fiscal year 2003-04 amounted to Rs.46,659 crore which included an additional allocation of Rs.29,000 crore under the DSS. Taking into account repayments of Rs.4,145 crore, the gross allocation amounted to Rs.50,805 crore. An amount of Rs.50,521 crore was actually raised during the year, of which Rs.26,623 crore was raised under the DSS for repayment to the Centre. Interest rates on States' market loans declined to 5.78-6.40 per cent during 2003-04 from 6.67-8.00 per cent in 2002-03.

4.28 The large and increasing GFD of the States has led to a steady accumulation of debt over the years. The debt-GDP ratio of the States increased further to 29.1 per cent at end-March 2004 from 27.8 per cent at end-March 2003.

4.29 The stress on State finances has emanated from a sluggish growth in States' own tax revenue, deterioration in States' own non-tax revenue and a persistent increase in revenue expenditure, particularly in respect of the non-developmental component which includes interest payments, pensions and administrative services. Current devolution and transfers from the Centre to the States (comprising shareable tax revenue and grants) declined in the 1990s as a ratio to GDP but increased thereafter up to 2003-04 (Chart IV. 4).

4.30 On the revenue side, States' own tax-GDP ratio has shown a slight improvement over the years indicating, *inter alia*, the potential to garner much needed revenues through taxation of services, implementation of VAT and improvement in tax administration.

4.31 The sluggish growth in States' own non-tax revenue is a major concern. It reflects, *inter alia*, the levy of inappropriate user charges in respect of public services provided by the State Governments. In fact, over the 1990s, cost recovery (measured by the ratio of non-tax revenue to non-Plan revenue expenditure) has remained nearly unchanged in respect of education and health services (Table 4.12). Cost recovery in respect of economic services such as irrigation, power and roads has been better than that of social services as highlighted by the Eleventh Finance Commission (EFC). There is, however, scope for further improvement which would

Chart IV.4 : Composition of Revenue Receipts of the State Governments

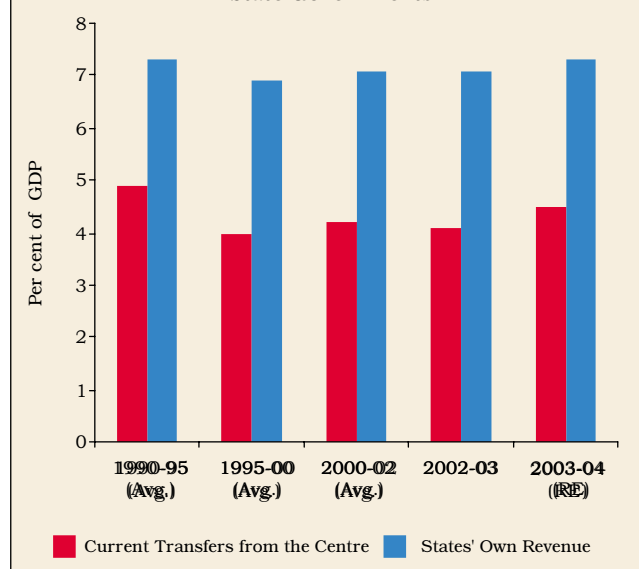


Table 4.12: Cost Recovery of Select Services of the State Governments*

| Item | (Per cent) | | | | |
|--------------------------|------------|---------|---------|---------|---------|
| | 2002-03P | 2001-02 | 2000-01 | 1995-00 | 1990-95 |
| 1 | 2 | 3 | 4 | 5 | 6 |
| Social Services | | | | | |
| Education | 1.4 | 1.2 | 1.2 | 1.1 | 1.2 |
| Health | 6.6 | 6.1 | 4.6 | 5.0 | 5.8 |
| Economic Services | | | | | |
| Irrigation | 9.6 | 7.5 | 8.1 | 7.3 | 9.6 |
| Power | 10.9 | 6.4 | 6.5 | 10.8 | 16.1 |
| Roads | 13.3 | 19.4 | 16.1 | 15.0 | 15.0 |

P : Provisional.

* : Ratio of Non-tax Revenue to Non-plan Revenue Expenditure.

Source : Budget documents of the State Governments.

enable wider provision of qualitatively superior services. Mobilisation of non-tax revenue has also been affected by the lacklustre financial performance of many State Public Sector Undertakings (SPSUs). In this context, the EFC had also observed that the average rate of return on capital invested in the State Electricity Boards that account for the bulk of States' investment in SPSUs has been persistently negative.

4.32 In consonance with the ongoing reforms in the power sector, there is, thus, an urgent need to modernise and restructure sick SPSUs, keeping in view the national objectives that they are intended to serve, including the imperatives of a globally competitive economy (Box IV.3).

Box IV.3

Public Sector Restructuring at the State Level

The restructuring of Public Sector Undertakings (PSUs) is an important element of the process of structural reforms. The overall objective of restructuring of PSUs is to enhance economic efficiency and growth. Issues relating to restructuring and its implications are, however, complex and largely unsettled as corroborated by the international experience. Although restructuring and privatisation are often perceived to be complementary, it is important to note that restructuring, which involves industrial and organisational changes, can take place independent of privatisation. Unbundling of the generation, transmission and distribution of electricity as well as decentralising former State regional companies to the municipal level are notable examples in this regard.

Alternative methods of privatisation, viz., public auctions, strategic sales, management/employee buyouts, management or lease contracts, mass privatisation or restitution could have differential social and financial impact. The fiscal implications of privatisation could also vary depending upon, *inter alia*, change in the budgetary support to PSUs following restructuring and the manner in which privatisation proceeds are utilised (say, for retiring public debt or for financing public expenditures). Thus, the decision to restructure or privatise PSUs would necessitate a comprehensive cost-benefit analysis.

In India, State Public Sector Undertakings (SPSUs) play a significant role in the achievement of developmental goals. There has, however, been a perceived need for restructuring some of the SPSUs in the context of a persistent deterioration in their financial performance over the years which has impacted their ability to meet the increasing demand for qualitatively superior public services. According to a Planning Commission Study (2002), in a sample of 747 SPSUs, 43 per cent belonged to manufacturing category, 22 per cent were promotional enterprises (which mainly focused on social activities), 12 per cent were utilities (mainly comprising State Road Transport Corporations and State Electricity Boards) and the balance belonged to trade and services, financial and welfare categories. These SPSUs recorded net losses during the 1990s, with a sharp increase in net losses evident since 1996-97. The financial performance, however, varied across categories. The manufacturing SPSUs - particularly the utility segments - made consistent losses, while the financial, trading and services and welfare segments almost invariably recorded profits. Promotional

enterprises showed a mixed performance over the period.

Some of the recent State Government budgets reflect efforts to undertake a comprehensive review of the functioning of their PSUs. Some of these State Governments have also been considering the possibility of closing down non-viable SPSUs after providing for suitable safety nets to the employees. A notable development has been the initiation of power sector reforms which include the constitution of State Electricity Regulatory Commissions (SERCs) for determining the tariff structure, unbundling of electricity boards into separate entities for power generation, transmission and distribution, increasing power tariffs and measures for reducing transmission and distribution losses.

A number of issues would need to be addressed in this regard including the cost and timeframe of restructuring, an objective and transparent process of divestiture and the provision of social safety nets (say, in the form of State Renewal Funds) in order to fully protect the interests of retrenched workers. A holistic review of labour laws may also be necessary. The Planning Commission study has recommended that SPSUs may be adequately compensated for carrying out social obligations through explicit budgetary provisions. As indicated in the Economic Survey 2003-04, the National Common Minimum Programme pledges to devolve full managerial and commercial autonomy to successful, profit making companies operating in a competitive environment, while it is also committed to the 'Navratna' companies remaining as PSUs. Furthermore, generally profit making companies will not be privatised and the process of privatisation would be transparent and on a consultative case-by-case basis.

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3. Planning Commission (2002), 'Final Report of the Study Group on Reforms in State Public Sector Undertakings', Government of India.
4. Government of India (2004), 'Economic Survey, 2003-04'.

4.33 The revised estimates for 2003-04 also indicate a further increase in the revenue expenditure-GDP ratio and a sharp rise in the capital expenditure to GDP ratio. The increase in capital expenditure during the year, however, largely reflected higher repayments of loans to the Centre under the DSS. In fact, capital outlay, which represents physical and financial investment, showed a relatively smaller increase.

4.34 The distortions in the pattern of expenditure are compounded by the fact that while the ratio of non-developmental expenditure to GDP increased in 2003-04 from the first half of the 1990s, the ratio of developmental expenditure to GDP remained unchanged (Chart IV.5).

4.35 Within non-developmental expenditure, interest payments continue to remain one of the major stress factors absorbing more than 25 per cent of revenue receipts in 2003-04, substantially higher than that of 18 per cent recommended by the Eleventh Finance Commission (EFC) from the viewpoint of debt sustainability over the medium term. Notwithstanding the saving under the DSS as well as across-the-board reduction in interest rates, total interest payments increased in 2003-04.

4.36 Pensions liabilities have also been a heavy drag on the State budgets, being non-contributory in nature and unsupported by any funding arrangements. In fact, pension liabilities have pre-empted nearly 10 per cent of revenue receipts in

recent years as compared with 3 per cent, on an average, during the early 1980s. Recognising the fiscal implications of increasing pension liabilities of the State Governments, some initiatives have been taken in this regard in the recent period (Box IV.4).

4.37 The observed weaknesses in State finances also have implications for the Local Governments in the context of fiscal decentralisation. Following the Seventy-third and Seventy-fourth Constitutional Amendment, there has been a renewed emphasis on the Local Governments. It is also increasingly recognised that the finances of the Local Governments are critical to the development of the socio-economic infrastructure and for the efficient delivery of public services (Box IV.5).

Contingent Liabilities

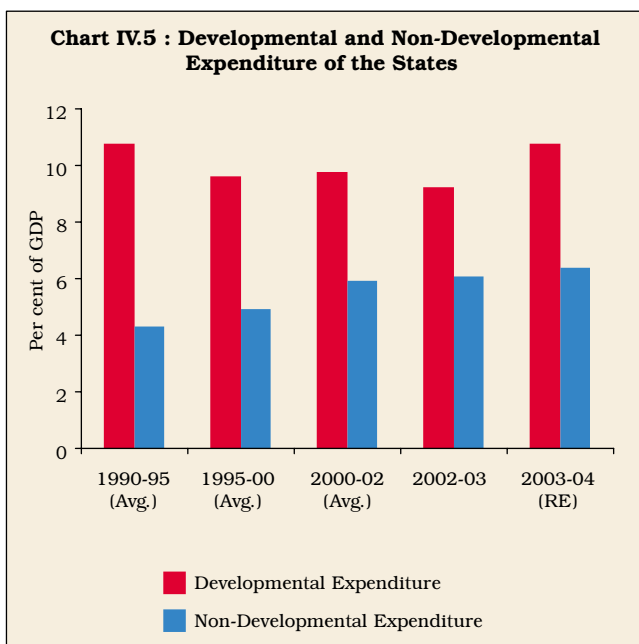
4.38 As alluded to earlier, outstanding guarantees of the State Governments have moderated since 2001-02. Although contingent liabilities do not directly form a part of the debt burden of the States, they will be required to meet debt service obligations in the event of default by the borrowing agency.

4.39 In view of fiscal implications of the rising level of guarantees, statutory ceilings on guarantees have been instituted by some States such as Goa, Gujarat, Karnataka, Sikkim and West Bengal, while some other States, viz., Assam, Orissa and Rajasthan have imposed administrative ceilings on guarantees.

4.40 The Reserve Bank has continued its efforts to sensitise the State Governments about the problems posed by increasing volumes of guarantees. As a part of its ongoing initiatives, a Standing Committee has been constituted within the Reserve Bank to collect and monitor information on State Government guaranteed advances and bonds from the investors' side, on a periodic basis.

Ways and Means Advances (WMA) of the States

4.41 Effective March 3, 2003, the Reserve Bank revised the Scheme of WMA for the States based on the recommendations of the Advisory Committee on WMA to State Governments (Chairman : Shri C. Ramachandran) and after consultations with the State Governments. In terms of the revised scheme, the total normal WMA limits for the State Governments



Box IV.4**Managing Pension Liabilities of the State Governments – Recent Initiatives**

Issues and concerns relating to social security schemes and civil service pension schemes, in particular, continue to engage the attention of academicians and policy makers. Even though civil service pensions started as a contributory system in many countries, Governments took over the liabilities of paying pensions out of public funds. In view of the growing pension liabilities, several countries subsequently initiated modifications in pension schemes which mainly focused on reducing the pension liabilities through parametric changes, gradually shifting towards some form of advance funding of benefit obligations and designing a system that allowed greater pension portability. In recent years, several countries have taken measures to reduce pension liabilities by, *inter alia*, introducing longer service periods, increasing the employee contribution rates and changing the post-retirement indexation policy.

In India, initiatives towards pension reforms are at a somewhat nascent stage. In August 2003, the Union Government approved the introduction of a restructured defined contributory pension system for new entrants to the Central Government services, except in the armed forces. An independent Pension Fund Regulatory and Development Authority was also set up to regulate and develop the pension market.

At the State Government level, the issue of increasing pension liabilities has also assumed critical importance since their unfunded and non-contributory nature has proved to be a mounting burden on the State budgets. So far, however, only a few State Governments (such as Rajasthan and Tamil Nadu) have initiated measures towards the introduction of a contributory pension scheme. Issues relating to State Government pensions came up for discussion during the Conference of State Finance Secretaries held in the Reserve Bank in January 2003. In accordance with the discussions, the Reserve Bank constituted a Group to Study the Pension Liabilities of the State Governments (Chairman: Shri B. K. Bhattacharya) in February 2003. The Group's Report was published in February 2004 and was placed on the Reserve Bank's website.

Some of the major recommendations of the Group are set out below:

Introduction of contributory pension scheme/s for all new employees of the State Governments in place of the existing non-contributory defined benefit pension scheme. The recommended alternative pension models are: (i) Pure Defined Contribution (DC) Scheme - the new employee and the Government each would contribute 10 per cent of the basic pay and dearness allowance to an individual account vested in a Fund which will be invested in accordance with the specified guidelines. At the time of retirement the employee will get an amount which will be the aggregate of the employee's contribution, Government's (employer's) contribution and the earnings (on investment made by the Fund) attributed to the employee's account; (ii) Defined Contribution -Defined Benefit (DC-DB) Scheme - a contributory scheme with guarantee of an appropriate level of pension fixed by individual State Governments; and (iii) A Two-Tier Scheme (*i.e.*, a DC-DB Scheme *plus* a second tier of DC Scheme) - the defined benefit in the first Tier of DC-DB scheme could be reduced from the present level of 50 per cent to an appropriate level of, say, 30 per cent and supplemented by a mandatory DC scheme, wherein both the employees and the State Governments make contributions.

A few parametric changes in the current pension scheme for both the existing employees and pensioners have become inevitable. These include immediate withdrawal of fixing of pensions on the basis of only last one month's pay, wherever applicable, eliminating wage indexation wherever applicable and reduction in the maximum permissible commutation amount from 40 per cent of Basic Pension to 33 1/3 per cent.

There is a need for setting up a "Dedicated Pension Fund" through levying a cess on/collecting contributions from all the existing employees, retaining a portion of increased salary and dearness allowance (DA) arising from the revisions in salary and DA in order to at least partially meet the pension burden of the existing employees and pensioners.

Reference

1. Reserve Bank of India (2003) , '*Report of the Group to Study Pension Liabilities of the State Governments*', October 2003.

were enhanced by 18.8 per cent to Rs.7,170 crore from the earlier limit of Rs.6,035 crore.

4.42 The utilisation of WMA and overdrafts by the States during 2003-04 was generally lower than that in the previous year. The number of States resorting to overdraft also declined from 21 in 2002-03 to 19 in 2003-04, indicating improved

management of cash flows. A detailed analysis of State Government borrowings including WMA is provided in Section XI on Public Debt Management.

4.43 Effective April 1, 2004, the total WMA limit was further enhanced by 13.5 per cent to Rs.8,140 crore. The other features of the WMA/Overdraft scheme 2003 remain unchanged.

Box IV.5

Local Government Finances - Issues and Experience

The evolving role of local governments in the context of fiscal decentralisation has been the subject of intense debate. The international experience indicates that in a large number of countries, the powers of the local governments are drawn from the upper tiers of the government (such as in Australia, Korea and Canada). In some countries (such as Germany and Brazil), their role and functions are specified by law. The responsibilities of the local bodies are generally uniform across countries and mainly include provision of education, health and sanitation, welfare and water supply, although the priority attached to each of these sectors has varied across countries. Local governments in many countries are unable to meet their expenditure from their own resources and depend largely on transfers and borrowings, wherever possible.

In India, rural and urban local bodies are reported to have been in existence since ancient times, although they acquired a democratically elected character only during the nineteenth century. As indicated in the Report of the Eleventh Finance Commission (EFC), there are more than a quarter million local governments, of which around 3,700 are in urban areas and the remaining in rural areas. Apart from providing specific public services, local bodies implement a number of Centrally sponsored and State Plan schemes.

The Seventy-third and Seventy-fourth Constitutional Amendments in 1992 accorded statutory recognition to these local bodies as institutions of self-government. These Amendments assigned to the local bodies the task of preparing plans for economic development and social justice, apart from their traditional functions. Notwithstanding the Constitutional requirement on the part of the State Legislatures, the EFC observed that 'the pace of empowerment of these (local) bodies to function as institutions of self-government has, however, generally been slow'. Most of the State Governments have also constituted State Finance Commissions (SFCs), as required by the statute, to review the financial position of the local bodies and recommend the devolution of financial resources. It has, however, been observed that the principal recommendations of the SFCs are not accepted by the State Governments and even the accepted recommendations are not always implemented on the grounds of resource constraint. Furthermore, funds transferred for the implementation of development schemes remain unspent either on account of institutional/procedural constraints or are diverted to meet other committed expenditure.

The significance of local bodies has greatly enhanced over the years, given the urgent need to improve infrastructural facilities, and accentuated to a large extent with the rapid pace of urbanisation. Several studies have shown that the

asymmetry in revenue and expenditure decentralisation is particularly stark at the local government level.

In recent years, a number of urban local bodies in India have accessed the capital market. It is important to note in this context that a number of countries (notably, Argentina) have placed prudential controls on local government borrowing, given their implications for general government finances. Borrowing for current expenditure is usually avoided (Canada, the USA and the UK). Mexico allows for pledging federal revenue-sharing funds to borrow from banks. The Government of India had, in February 2001, specified guidelines for the issue of Municipal Bonds. The Government had permitted the issue of tax-free bonds to finance the development of urban infrastructure subject to, *inter alia*, compulsory credit rating of the debt instrument and creation of an escrow account for debt servicing with earmarked revenue. The magnitude of funds raised *via* municipal bonds, however, remains small. The factors that are reported to have been impeding the development of the municipal debt market include (i) weak financial position of local bodies, (ii) cash-based (instead of accrual-based) accounting systems which do not capture information about the asset-liability profile, (iii) relatively short tenure of bonds in relation to the gestation period of infrastructure projects that are being financed and (iv) absence of bond banks (as in the US) that access capital market and then on-lend to smaller local bodies.

As far as mobilisation of funds are concerned, an area of concern relates to the guarantees provided by State Governments to the borrowings of urban local bodies from public financial institutions to augment urban infrastructure facilities. These contingent liabilities of the State Governments are a potential source of instability in their finances. Another area of concern, as highlighted by the EFC, is the non-availability of data on the finances of local bodies. The absence of an institutionalised mechanism for collection of such data has greatly circumscribed in-depth analysis.

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3. Rangarajan C., (2003), 'Inaugural Address in the National Seminar on Municipal Finance', Indian Institute of Public Administration, December 29-30.
4. 3i Network (2003), '*India Infrastructure Report - Public Expenditures Allocation and Accountability*', Oxford University Press.

COMBINED BUDGETARY POSITION OF THE CENTRE AND THE STATES

4.44 The combined revenue receipts of the Centre and the States in 2003-04 (RE) exceeded their budgeted levels. While both the tax and non-tax revenues increased

over the previous year, the rise was more pronounced in respect of non-tax revenue. The increase in combined revenue expenditure, however, outpaced the rise in revenue receipts, resulting in a higher revenue deficit. The combined aggregate expenditure exceeded the

Table 4.13: Indicators of Combined Finances of the Centre and the States*

(Rupees crore)

| Item | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 1995-96 | 1990-91 | Variation | |
|--|-------------------|-------------------|-------------------|-----------------|-----------------|----------------------|----------|
| | | | | | | RE over BE (2003-04) | |
| | | | | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Gross Fiscal Deficit | 2,60,217 (9.4) | 2,59,200 (9.4) | 2,34,923 (9.5) | 77,671 (6.5) | 53,580 (9.4) | 1,017 | 0.4 |
| Revenue Deficit | 1,72,100 (6.2) | 1,61,116 (5.9) | 1,63,053 (6.6) | 37,932 (3.2) | 23,871 (4.2) | 10,983 | 6.8 |
| Primary Deficit | 80,214 (2.9) | 83,333 (3.0) | 76,475 (3.1) | 18,598 (1.6) | 28,585 (5.0) | -3,119 | -3.7 |
| Total Receipts(A+B) | 8,72,973 | 8,12,595 | 7,30,509 | 2,96,629 | 1,52,398 | 60,378 | 7.4 |
| A. Revenue Receipts (1+2) | 5,29,248 | 5,18,090 | 4,50,464 | 2,17,527 | 1,05,757 | 11,158 | 2.2 |
| 1. Tax Receipts (a+b) | 4,15,283 | 4,13,057 | 3,57,889 | 1,74,852 | 87,564 | 2,226 | 0.5 |
| a) Direct taxes | 1,21,970 | 1,16,463 | 1,01,067 | 41,603 | 14,267 | 5,507 | 4.7 |
| b) Indirect taxes | 2,93,313 | 2,96,593 | 2,56,822 | 1,33,248 | 73,297 | -3,280 | -1.1 |
| 2. Non-tax Receipts | 1,13,965 | 1,05,033 | 92,575 | 42,675 | 18,193 | 8,932 | 8.5 |
| B. Capital Receipts (a+b) | 3,43,725 | 2,94,506 | 2,80,045 | 79,102 | 46,641 | 49,219 | 16.7 |
| a) Non-debt Capital Receipts | 37,835 | 21,273 | 16,065 | 6,968 | 3,233 | 16,562 | 77.9 |
| b) Debt Capital Receipts | 3,05,890 | 2,73,233 | 2,63,980 | 72,134 | 43,408 | 32,658 | 12.0 |
| Aggregate Expenditure (4+5) | 8,85,293 | 8,19,833 | 7,26,139 | 3,03,586 | 1,63,673 | 65,460 | 8.0 |
| 1. Revenue Expenditure | 7,01,348 | 6,79,205 | 6,13,517 | 2,55,457 | 1,29,628 | 22,144 | 3.3 |
| 2. Capital Outlay | 97,023 | 97,343 | 65,310 | 32,594 | 21,370 | -321 | -0.3 |
| 3. Loans and Advances | 28,927 | 22,013 | 22,625 | 14,115 | 11,589 | 6,914 | 31.4 |
| 4. Development Expenditure | 4,39,465 | 4,05,720 | 3,57,948 | 1,65,361 | 98,686 | 33,745 | 8.3 |
| 5. Non-Development Expenditure (including others)@ | 4,45,827 | 4,14,113 | 3,68,191 | 1,38,225 | 64,987 | 31,714 | 7.7 |

RE : Revised Estimates.

BE : Budget Estimates.

* : Data in respect of the State Governments are provisional from 2002-03 onwards.

@ : Others include compensation and assignments to local bodies and discharge of internal liabilities by the States and repayments to the National Small Savings Fund (NSSF) by the Centre.

Notes : 1. Inter-Governmental transactions have been netted out.

2. Figures in parentheses are percentages to GDP.

3. Combined GFD is the GFD of the Centre and the State Governments *minus* net lending from the Central Government to the States.

4. Revenue Deficit is the difference between revenue receipts and revenue expenditure adjusted for inter-Governmental transactions in the revenue account.

5. Gross primary deficit is defined as the combined GFD *minus* combined interest payments.

budget estimates on account of higher than anticipated revenue expenditure and loans and advances, while capital outlay was marginally lower than in the budget estimates. Relatively higher growth in aggregate expenditure *vis-à-vis* revenue receipts led to an increase in the GFD over the budgeted level. While in terms of GDP, the revenue deficit was higher by 0.3 percentage points over the budget estimates, the gross fiscal deficit remained unchanged at the budgeted level (Table 4.13).

Combined Debt

4.45 The combined outstanding liabilities of the Centre and the State Governments have risen steadily in recent years. During the period 1990-91 to 2003-04, outstanding liabilities of the Central Government increased by 6.9 percentage points of GDP, while those of the States showed an increase of 9.7 percentage points (Table 4.14).

Table 4.14: Combined Liabilities of the Centre and the States

| Year (end-March) | Outstanding Liabilities | | | Debt - GDP Ratio | | |
|---------------------|-------------------------|----------|-----------|------------------|--------|----------|
| | (Rupees crore) | | | (per cent) | | |
| | Centre | States | Combined | Centre | States | Combined |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 1990-91 | 3,14,558 | 1,10,289 | 3,50,957 | 55.3 | 19.4 | 61.7 |
| 1995-96 | 6,06,232 | 2,12,225 | 6,89,545 | 51.0 | 17.9 | 58.0 |
| 2001-02 | 13,66,408 | 5,86,686 | 16,28,972 | 59.9 | 25.6 | 71.4 |
| 2002-03 | 15,59,201 | 6,86,142 | 18,70,519 | 63.1 | 27.8 | 75.7 |
| 2003-04 RE | 17,24,499 | 8,05,667 | 21,25,151 | 62.2 | 29.1 | 76.7 |
| 2004-05 BE | 19,86,167 | 9,10,902 | 24,20,091 | 63.6 | 29.2 | 77.5 |

RE: Revised Estimates.

BE: Budget Estimates.

Note: 1. Data in respect of the States are provisional since 2002-03.

2. Under the head 'combined' inter-Governmental transactions are netted out.

FISCAL OUTLOOK FOR 2004-05²

Central Government

4.46 The Union Budget, 2004-05 was presented against the backdrop of sound macroeconomic fundamentals. The Fiscal Responsibility and Budget

Management (FRBM) Act, 2003 has further streamlined the budget presentation process. The commitment to prudent financial policies has been demonstrated by notifying the FRBM Act, 2003 and FRBM Rules, 2004 with effect from July 5, 2004 (Box IV.6). More importantly, while presenting the

Box IV.6

The Fiscal Responsibility and Budget Management Act

Fiscal rules have become an imperative in the context of the need to restrain discretionary policies which have an inherent deficit bias. Fiscal rules could be defined as legislated or constitutional constraints on government deficits, taxes, expenditures or debt. The adoption of fiscal policy rules commits the Government to a deficit or debt reduction path into the future, thereby enhancing the credibility of the fiscal stance.

International experience shows that a number of countries facing widening fiscal imbalances have introduced medium-term fiscal adjustment plans through the adoption of rules: the medium-term Financial Strategy in the U.K., the Balanced Budget and Emergency Deficit Control Act [Gramm Rudman Hollings Act in the U.S of 1985], Fiscal responsibility legislations in New Zealand (1994), Argentina (1999), Peru (1999) and Brazil (2002).

In India, the Fiscal Responsibility and Budget Management Act, 2003 was enacted on August 26, 2003 and came into force from July 5, 2004. The Act embodies the spirit of inter-generational equity and provides for long-term macroeconomic stability by achieving sufficient revenue surplus and removing the fiscal constraints on the conduct of monetary policy and debt management. This is sought to be achieved through limits on deficits, borrowings and debt of the Central Government over the medium-term while increasing transparency of fiscal operations.

The Act also stipulates appropriate measures by the Central Government to reduce the fiscal deficit and eliminate revenue deficit by March 31, 2008 and thereafter build up adequate revenue surplus (The Union Budget for 2004-05 proposes to eliminate the revenue deficit by 2008-09). These deficits could, however, exceed the targets on grounds of national security, natural calamity or other exceptional circumstances. The Act prohibits direct borrowings by the Centre from the Reserve Bank from the fiscal year 2006-07 except by way of Ways and Means Advances to meet temporary mismatches in receipts and payments or under exceptional circumstances. The Reserve Bank may, however, buy or sell Central Government securities in the secondary market. The Act also contains provision to enhance transparency in the Central Government's fiscal operations by requiring the Government to place before

the Parliament the outcome of a quarterly review of trends in receipts and expenditure in relation to the budget estimates.

In exercise of the powers conferred by the FRBM Act 2003, the Central Government framed the Fiscal Responsibility and Budget Management Rules, 2004, effective July 5, 2004. The Rules have set annual targets for the phased reduction in key deficit indicators over the period ending March 31, 2008. The rules also impose annual ceilings on Government guarantees and additional liabilities.

In accordance with the Rules framed under the FRBM Act, the Government presented the Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macroeconomic Framework Statement along with the Annual Financial Statement for 2004-05. The Medium-term Fiscal Policy Statement sets forth a three-year rolling target for certain fiscal indicators and elucidates the underlying assumptions. It also included an assessment of sustainability relating to the balance between revenue receipts and revenue expenditure and the use of capital receipts (including market borrowings) for generating productive assets. The Fiscal Policy Strategy Statement contains, *inter alia*, the key fiscal measures and rationale for any major deviation in these measures. The Macroeconomic Framework Statement provides an assessment of the growth prospects of the economy.

References

1. Government of India (2003), '*Fiscal Responsibility and Budget Management Act, 2003*', August.
2. Kennedy, Suzanne and Janine Robbins (2001), '*The Role of Fiscal Rules in Determining Fiscal Performance*', Canadian Department of Finance, Working Paper No.16.
3. Kopits, George (2001), '*Fiscal Rules: Useful Policy Framework or Unnecessary Ornament?*', Fiscal Rules, Public Finance Workshop, Banca D'Italia.
4. Reserve Bank of India (2004), '*State Finances - A Study of Budgets of 2003-04*', April.
5. Government of India (2004), '*Union Budget, 2004-05*'.

² All comparisons in this section relating to 2004-05 are with respect to revised estimates for 2003-04, unless otherwise stated.

Table 4.15: Major Fiscal Indicators of the Centre

(Rupees crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | Variation (Col.3/Col.2) | |
|---|----------------------------------|----------------------------------|-------------------------|-------------|
| | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 |
| Total Receipts | 4,77,829 (15.3) | 4,74,255 (17.1) | 3,574 | 0.8 |
| Revenue Receipts | 3,09,322 (9.9) | 2,63,027 (9.5) | 46,295 | 17.6 |
| Tax Revenue (Net) | 2,33,906 (7.5) | 1,87,539 (6.8) | 46,367 | 24.7 |
| Capital Receipts | 1,68,507 (5.4) | 2,11,228 (7.6) | -42,721 | -20.2 |
| Total Expenditure | 4,77,829 (15.3) | 4,74,255 (17.1) | 3,574 | 0.8 |
| Revenue Expenditure | 3,85,493 (12.3) | 3,62,887 (13.1) | 22,606 | 6.2 |
| Capital Expenditure | 92,336 (3.0) | 1,11,368 (4.0) | -19,032 | -17.1 |
| <i>Expenditure Excluding Repayments to NSSF</i> | | | | |
| Total Expenditure | 4,77,829 (15.3) | 4,27,653 (15.4) | 50,176 | 11.7 |
| Capital Expenditure | 92,336 (3.0) | 64,766 (2.3) | 27,570 | 42.6 |
| Gross Fiscal Deficit | 1,37,407 (4.4) | 1,32,103 (4.8) | 5,304 | 4.0 |
| Revenue Deficit | 76,171 (2.5) | 99,860 (3.6) | -23,689 | -23.7 |
| Primary Deficit | 7,907 (0.3) | 7,548 (0.3) | 359 | 4.8 |
| BE: Budget Estimates. RE: Revised Estimates. | | | | |
| Note: Figures in parentheses are percentages to GDP. | | | | |

Budget, the Government has also placed before the Parliament three important documents, viz., (i) Macroeconomic Framework Statement, (ii) Medium-Term Fiscal Policy Statement, and (iii) Fiscal Policy Strategy Statement. These documents assume critical importance in the context of the commitment to fiscal prudence, transparency and budget integrity.

4.47 The Union Budget for 2004-05 has endeavoured to carry forward the process of fiscal consolidation, essentially based on a projected upsurge in revenue mobilisation coupled with some deceleration in expenditure. A notable feature of the budget estimates is the reduction of nearly 24 per cent in the revenue deficit in 2004-05 on top of the

decline of about 7 per cent in the previous year. As a consequence, the revenue deficit is placed lower in 2004-05 than the revised estimates of the previous year and the average during the second half of the 1990s. The GFD-GDP ratio is also budgeted to decline in 2004-05 in comparison with recent trends (Table 4.15).

4.48 The Union Government constituted a Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003 (Chairman: Dr. Vijay L. Kelkar) to suggest ways of achieving the fiscal targets prescribed by the FRBM Act, 2003. The Task Force submitted its Report to the Government in July 2004, providing the road map for attaining the fiscal targets set in the FRBM Act (Box IV.7).

Box IV.7

Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003

The Government of India set up a Task Force (Chairman: Dr. Vijay Kelkar) to draw up the medium-term framework for fiscal policies to achieve the objectives set out in the Fiscal Responsibility and Budget Management Act (FRBM), 2003. The Report of the Task Force, which was submitted on July 16, 2004, attempted to address the issue of fiscal planning in two steps, viz., (i) to provide baseline projections, with a forecast of broad contours of Central finances, and (ii) to devise policy proposals which close the gaps, if any, identified between the baseline projection and the requirements of the Act.

The Task Force advocated a fiscal strategy based on revenue augmentation and front-loaded efforts on revenue expenditure reforms in order to counter-balance the contractionary effects of the fiscal consolidation. The Task Force also made specific recommendations for tax reforms, tax administration and expenditure reforms. The tax-specific recommendations focused on widening the tax base; rationalising the tax system; enhancing vertical and horizontal equity of the tax system; shifting to a destination-based VAT on all goods and services; enhancing the neutrality of the tax system in respect of the timing of consumption, form of organisation and sources of finance; establishing an effective and efficient compliance system; and improving tax buoyancy rather than immediacy of tax revenue.

The Task Force made two major proposals regarding tax administration, i.e., the implementation of the proposed

Goods and Services Tax (GST) and measures to avoid tax evasion. Since the efficient implementation of GST system entails tax credits and refund of GST embedded in exports, the Task Force recommended that the existing Tax Information Network (TIN) and Online Tax Administration System (OLTAS) developed by the Central Board of Direct Taxes (CBDT) should be used for the implementation of the GST, both by the Centre and the States. The Task Force also proposed an IT-intensive system, viz., Risk Intelligence Network (RIN) in order to identify tax evaders, while simultaneously having a taxpayer friendly system.

In the area of expenditure reforms, the broad strategy suggested by the Task Force related to greater allocation for legitimate public goods as opposed to transfers and subsidies; transfer production of local public goods like water, sanitation and primary education to *Panchayati Raj* institutions; greater focus on public goods outcomes rather than their expenditure; and extension of public-private partnership. The Task Force projected that under the reforms scenario, a small revenue surplus would be generated by 2008-09 and the fiscal deficit would dip below 3 per cent of GDP (Table).

The fiscal reforms proposed by the Task Force are expected to have a positive impact on investment, health, education, manufacturing, exports, financial sector, growth, employment and State finances.

Table : Fiscal Projections under Baseline/ Reforms Scenarios

(Per cent of GDP)

| Item | 2005-06 | | 2006-07 | | 2007-08 | | 2008-09 | |
|-------------------------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
| | Baseline Scenario | Reforms Scenario | Baseline Scenario | Reforms Scenario | Baseline Scenario | Reforms Scenario | Baseline Scenario | Reforms Scenario |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| 1. Revenue Receipts | 9.36 | 10.27 | 9.31 | 10.78 | 9.32 | 10.99 | 9.42 | 11.18 |
| Tax revenue, net to Centre | 7.20 | 8.14 | 7.41 | 8.91 | 7.55 | 9.34 | 7.91 | 9.73 |
| Non-tax revenue | 2.16 | 2.13 | 1.91 | 1.87 | 1.53 | 1.65 | 1.51 | 1.44 |
| 2. Non-debt Capital Receipts | 0.50 | 0.61 | 0.43 | 0.41 | 0.37 | 0.37 | 0.33 | 0.32 |
| Recoveries of loans | 0.39 | 0.49 | 0.33 | 0.31 | 0.28 | 0.28 | 0.25 | 0.24 |
| Other receipts | 0.12 | 0.12 | 0.10 | 0.10 | 0.09 | 0.09 | 0.08 | 0.08 |
| 3. Total Expenditure | 14.76 | 14.90 | 14.42 | 14.75 | 14.01 | 14.48 | 13.74 | 14.30 |
| i. Revenue Expenditure | 11.91 | 12.03 | 11.63 | 11.85 | 11.30 | 11.31 | 11.08 | 11.03 |
| of which : | | | | | | | | |
| a) Interest, debt servicing | 4.14 | 4.07 | 4.08 | 3.92 | 4.00 | 3.74 | 3.91 | 3.54 |
| b) Subsidies | 1.28 | 1.28 | 1.13 | 1.13 | 0.92 | 0.91 | 0.82 | 0.80 |
| ii. Capital Expenditure | 2.85 | 2.87 | 2.79 | 2.90 | 2.71 | 3.17 | 2.65 | 3.27 |
| 4. Revenue Deficit | 2.61 | 1.76 | 2.35 | 1.07 | 1.98 | 0.33 | 1.66 | (-0.15) |
| 5. Fiscal Deficit | 4.96 | 4.03 | 4.71 | 3.56 | 4.32 | 3.13 | 3.98 | 2.80 |
| <i>Memo Item:</i> | | | | | | | | |
| Gross Tax Revenue | 9.72 | 11.05 | 10.00 | 12.07 | 10.33 | 12.64 | 10.70 | 13.17 |

Reference

- Government of India (2004), 'Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003', July.

Table 4.16: Decomposition of GFD of the Centre

(Per cent)

| Year | Revenue Deficit | Capital Outlay @ | Net Lending |
|--------------|-----------------|------------------|-------------|
| 1 | 2 | 3 | 4 |
| 1990-91 | 41.6 | 27.2 | 31.2 |
| 1991-92 | 44.8 | 23.0 | 32.2 |
| 1992-93 | 46.2 | 29.0 | 24.7 |
| 1993-94 | 54.3 | 22.0 | 23.7 |
| 1994-95 | 53.8 | 17.0 | 29.2 |
| 1995-96 | 49.4 | 22.8 | 27.8 |
| 1996-97 | 48.9 | 20.7 | 30.4 |
| 1997-98 | 52.2 | 18.7 | 29.1 |
| 1998-99 | 59.1 | 11.4 | 29.5 |
| 1999-00 | 64.6 | 21.3 | 14.1 |
| 2000-01 | 71.7 | 19.0 | 9.2 |
| 2001-02 | 71.1 | 16.3 | 12.7 |
| 2002-03 | 74.4 | 27.4 | -1.7 |
| 2003-04 (RE) | 75.6 | 16.5 | 7.9 |
| 2004-05 (BE) | 55.4 | 34.7 | 9.8 |

@ : Adjusted for disinvestment receipts from 1991-92.

4.49 The envisaged improvement in the revenue balance would facilitate the correction in the GFD. Although the share of the revenue deficit in the GFD is envisaged to be lower in 2004-05 as compared with the previous year, it continues to be high as compared with the first half of the 1990s (Table 4.16).

Pattern of Receipts

4.50 Gross tax revenue is budgeted to increase by about 25 per cent in 2004-05 as compared with 17.6 per cent in the previous year (Table 4.17). The gross tax to GDP ratio is accordingly estimated higher in 2004-05 than in the previous year and the average for the second half of the 1990s. Substantial increases are expected in respect of corporation tax (40.4 per cent), income tax (26.5 per cent), union excise duty (18.2 per cent) and service tax (70.5 per cent). In contrast, the growth in customs duty (9.9 per cent) is expected to be modest in line with the policy of rationalising customs duty, the ultimate objective being a transition to the uniform tax rate (Box IV.8).

4.51 Union excise duty and corporation tax are budgeted to account for over 60 per cent of the increase in gross tax revenue in 2004-05. The expected higher mobilisation of tax revenue reflects a variety of measures including the two per cent education cess, raising of the service tax rate coupled with the widening of coverage and the special drive

Table 4.17: Revenue Position of the Centre

(Rupees crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | Variation (Col. 2 / 3) | |
|--------------------------|-----------------|-----------------|------------------------|-------------|
| | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 |
| Total Receipts | 4,77,829 | 4,74,255 | 3,574 | 0.8 |
| | (15.3) | (17.1) | | |
| Revenue Receipts | 3,09,322 | 2,63,027 | 46,295 | 17.6 |
| | (9.9) | (9.5) | | |
| Tax Revenue (Net) | 2,33,906 | 1,87,539 | 46,367 | 24.7 |
| | (7.5) | (6.8) | | |
| Non-tax Revenue | 75,416 | 75,488 | -72 | -0.1 |
| | (2.4) | (2.7) | | |
| Capital Receipts | 1,68,507 | 2,11,228 | -42,721 | -20.2 |
| | (5.4) | (7.6) | | |
| <i>Memo Items :</i> | | | | |
| Gross Tax Revenue | 3,17,733 | 2,54,923 | 62,810 | 24.6 |
| | (10.2) | (9.2) | | |
| Corporation Tax | 88,436 | 62,986 | 25,450 | 40.4 |
| | (2.8) | (2.3) | | |
| Income Tax | 50,929 | 40,269 | 10,660 | 26.5 |
| | (1.6) | (1.5) | | |
| Customs Duty | 54,250 | 49,350 | 4,900 | 9.9 |
| | (1.7) | (1.8) | | |
| Union Excise Duty | 1,09,199 | 92,379 | 16,820 | 18.2 |
| | (3.5) | (3.3) | | |
| Service Tax | 14,150 | 8,300 | 5,850 | 70.5 |
| | (0.5) | (0.3) | | |

BE : Budget Estimates.

RE : Revised Estimates.

Note : Figures in parentheses are percentages to total.

to recover arrears in respect of both direct and indirect taxes (Chart IV.6).

4.52 Non-tax revenue is, however, budgeted to decline marginally in 2004-05, mainly reflecting the sharp reduction of over Rs.5,000 crore in dividends and profits transferred by the Reserve Bank, nationalised banks and financial institutions. Furthermore, interest receipts from the State Governments are budgeted to increase by only 4 per cent in 2004-05, reflecting saving by the States on interest costs on account of the DSS as well as the envisaged saving of Rs.375 crore from the reduction in the rate of interest on Central loans to 9.0 per cent with effect from April 1, 2004 as against 10.5 per cent in the previous year.

4.53 Capital receipts are budgeted to decline from the revised estimates for 2003-04. Non-debt capital receipts, both under recovery of loans (which includes Rs.11,000 crore under the debt swap scheme) and under disinvestment, are estimated to be lower than

Box IV.8

Uniform versus Multiple Tax Rate

In developing countries, taxes are levied with multiple objectives: mobilising revenue, protection of domestic industries and promotion of strategic industries. The tax rate structure in developing countries is complex due to high and multiple rates coupled with exemptions on several commodities. Multiple tax rates are often the source of high administrative cost and inconvenience to the taxpayers. Many countries have gradually rationalised multiple rates of taxes in the wake of globalisation and the need for ensuring greater tax efficiency. It has also been observed that de-escalating tariffs yield the highest welfare when the benefits of agglomeration are very high.

There are several arguments in the literature in favour of a uniform tax regime. Uniform tax rates facilitate tax smoothening and stabilise expectations among economic agents. Besides, a uniform rate is administratively convenient and enhances transparency of the tax system. Uniform tax rates also obviate moral hazard problems of lobbying and smuggling and other hidden actions that cannot be fully monitored. Among the indirect taxes, excise duties and customs duties are the major taxes which can be subjected to a uniform tax rate. Uniform taxation, however, may not be appropriate in the presence of externalities. Furthermore, considerations of equity and redistribution of wealth provide a strong case for a differentiated indirect tax structure.

The Task Force on Indirect Taxes (Chairman: Dr Vijay L. Kelkar), 2002 was of the view that a simple tax law is not only cost effective and easy to administer but would also encourage compliance and have a positive impact on tax revenues. As a

policy, it recommended that multiplicity of levies must be reduced. However, it did not favour a single duty regime. On import tariffs, the Tax Reforms Committee (Chairman: Dr. Raja Chelliah), 1992 ruled out a single duty rate regime and favoured a limited number of rates. It recommended that all commodities should be subjected to a minimum tariff. The Task Force recommended that there should be only three types of duties, viz., Basic Customs Duty, Additional Duty of Customs (or Countervailing duty) and Anti-dumping/Safeguard duties. An Inter-Ministerial Group on Customs Tariff Structure constituted by the Ministry of Finance (Chairman: Dr. Arvind Virmani) in 2001 favoured uniformity of customs duty. The Group specifically recommended that no new end-use exemptions should be given and existing ones should be eliminated at the earliest. A recent study has recommended a uniform tariff rate of 15 per cent for all import items, including defence, which would not have any adverse revenue implications.

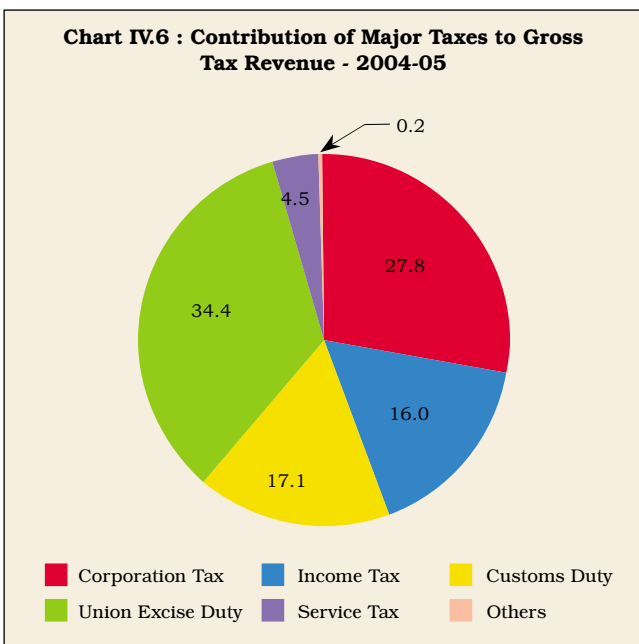
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in the revised estimates for 2003-04. Net market borrowings through dated securities and 364-day

Treasury Bills [net of issuance under the Market Stabilisation Scheme (MSS)] are budgeted to increase by 5.5 per cent over the previous year (Table 4.18).

Chart IV.6 : Contribution of Major Taxes to Gross Tax Revenue - 2004-05



Pattern of Expenditure

4.54 As a proportion to GDP, total expenditure is estimated to be lower than in the previous year. Revenue expenditure would show a similar reduction. Capital expenditure, which increased sharply in 2003-04 mainly as a result of redemption of securities to the NSSF, would decline to 3.0 per cent of GDP in 2004-05.

4.55 Within revenue expenditure, the major non-Plan components, viz., interest payments and subsidies, are budgeted to show a decline in relation to GDP. Total provision for subsidies is budgeted to decline even in nominal terms during 2004-05, notwithstanding the higher outgo on food and fertiliser subsidies (Table 4.19). This is essentially on account of a decline of over Rs.3,000 crore in petroleum subsidy (which includes subsidies for domestic LPG and PDS kerosene) in line with the decision to phase it out over a period of time. The ratio of interest payments to GDP would also show

Table 4.18: Capital Receipts of the Centre

(Amount in Rupees crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | Variation Col. 2 over Col. 3 | |
|---|-----------------|-----------------|---------------------------------|--------------|
| | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 |
| Capital Receipts | 1,68,507 | 2,11,228 | -42,721 | -20.2 |
| Non-debt Capital Receipts | 31,100 | 79,125 | -48,025 | -60.7 |
| Debt Capital Receipts | 1,37,407 * | 1,32,103 | 5,304 | 4.0 |
| BE : Budget Estimates. RE : Revised Estimates. * : Net of issuances under the MSS. | | | | |

a decline in 2004-05. Similarly, the absence of any provision for premium on prepayment of external debt (as compared with that of Rs.4,080 crore in the previous year) would contribute to the subdued growth in non-Plan revenue expenditure in 2004-05. Total establishment expenditure in the form of pay, allowances and travel expenses (excluding those in respect of defence personnel and Railways) is estimated to pre-empt 6.7 per cent (Rs.20,782 crore) of revenue receipts in 2004-05 as compared with 8.1 per cent in the previous year. Pensions would absorb 5.1 per cent (Rs.15,928 crore) of revenue receipts in 2004-05 as compared with 5.8 per cent in the previous year.

4.56 Plan revenue expenditure is budgeted to increase sharply by 17.6 per cent in 2004-05, mainly reflecting the renewed thrust on Central Plan schemes. As a ratio to GDP, however, Plan revenue expenditure would increase marginally by 0.1 percentage points to 2.9 per cent.

4.57 While there is a renewed thrust on developmental goals in the budget estimates for 2004-05, the allocation of expenditure on select heads indicates some elements of continuity (Table 4.20).

Financing of Gross Fiscal Deficit

4.58 Net market borrowings (excluding allocations budgeted under the MSS) would finance 65.8 per cent of the GFD in 2004-05 as compared with 64.9 per cent in the previous year. About 10 per cent of the GFD would be financed by drawing down surplus cash balances with the Reserve Bank. Contributions from other sources are budgeted to finance 14.4 per cent of the GFD as compared with 2.6 per cent in 2003-04, mainly on account of the budgeted increase in Savings Bonds. The securities against small savings are expected to finance only 1.0 per cent of the fiscal deficit (as against 45.7 per cent in the previous year) as there is no budgetary provision for repayment to the NSSF from the receipts under the DSS. The

Table 4.19: Expenditure Pattern of the Centre

(Rupees crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | Variation (Col.2 /Col. 3) | |
|---|-----------------|-------------------|----------------------------|-------------|
| | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 |
| Total Expenditure | 4,77,829 | 4,27,653 * | 50,176 | 11.7 |
| | (15.3) | (15.4) | | |
| Non-Plan Expenditure | 3,32,239 | 3,06,146 * | 26,093 | 8.5 |
| | (10.6) | (11.0) | | |
| Interest Payments | 1,29,500 | 1,24,555 | 4,945 | 4.0 |
| | (4.1) | (4.5) | | |
| Defence | 77,000 | 60,300 | 16,700 | 27.7 |
| | (2.5) | (2.2) | | |
| Subsidies | 43,516 | 44,709 | -1,193 | -2.7 |
| | (1.4) | (1.6) | | |
| Grants/loans to States | 19,576 | 15,850 | 3,726 | 23.5 |
| | (0.6) | (0.6) | | |
| Other Non-Plan Expenditure | 62,647 | 60,732 | 1,915 | 3.2 |
| | (2.0) | (2.2) | | |
| Plan Expenditure | 1,45,590 | 1,21,507 | 24,083 | 19.8 |
| | (4.7) | (4.4) | | |
| Budgetary Support to Central Plan | 87,886 | 72,847 | 15,039 | 20.6 |
| | (2.8) | (2.6) | | |
| Central Assistance for State and UT Plans | 57,704 | 48,660 | 9,044 | 18.6 |
| | (1.8) | (1.8) | | |
| * : Net of repayments to the NSSF. Note: Figures in parentheses are percentages to GDP. | | | | |

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Table 4.20: Expenditure on Select Developmental Heads of the Centre

(Rupees crore)

| | 2004-05(BE) | 2003-04 (RE) | 2002-03 |
|--------------------|--------------------|--------------------|--------------------|
| 1 | 2 | 3 | 4 |
| Agriculture | 36,349 (7.6) | 33,126 (7.0) | 31,185 (7.5) |
| Education | 11,480 (2.4) | 10,738 (2.3) | 9,519 (2.3) |
| Health | 5,956 (1.2) | 4,632 (1.0) | 4,007 (1.0) |
| Rural Development* | 6,926 + (1.4) | 11,466 (2.4) | 11,703 (2.8) |
| Irrigation | 361 (0.1) | 372 (0.1) | 366 (0.1) |
| Total Expenditure | 477,829 (100.0) | 474,255 (100.0) | 414,162 (100.0) |

BE : Budget Estimates. RE : Revised Estimates.

* : Comprising expenditure on special programmes for rural development, rural employment, land reforms and other rural development programmes.

+ : The fall in this allocation may be seen in conjunction with the lump sum provision of Rs.10,000 crore to the Planning Commission for reallocation to primary rural development activities.

Note: Figures in parentheses are percentages to total expenditure.

securities against small savings during 2004-05 represent reinvestment by the NSSF out of funds to be received on redemption of State Government special securities (Table 4.21).

State Budgets - 2004-05

4.59 A significant correction of fiscal imbalances is to be effected in the finances of the States in 2004-05 through a compression of developmental and investment-oriented expenditures. All the major deficit

Table 4.21: Financing of Gross Fiscal Deficit of the Centre

(Rupees crore)

| Year | 2004-05 BE | 2003-04 RE |
|--|------------------|-------------------|
| 1 | 2 | 3 |
| Gross Fiscal Deficit | 1,37,407 | 1,32,103 |
| <i>Financed by:</i> | | |
| Market Borrowings* | 90,365 (65.8) | 85,671 (64.9) |
| State Provident Funds | 4,000 (2.9) | 5,000 (3.8) |
| NSSF Investment in Central Government Special Securities | 1,350 (1.0) | 60,400 (45.7) |
| Special Deposits | 200 (0.1) | -451 # (-0.3) |
| External Assistance | 8,076 (5.9) | -11,705 (-8.9) |
| Drawdown of cash balances | 13,597 (9.9) | -10,232 (-7.7) |
| Others@ | 19,819 (14.4) | 3,420 (2.6) |

BE : Budget Estimates. RE : Revised Estimates.

* : Includes dated securities and 364-day Treasury Bills.

: Reduction in receipts is on account of freezing of the corpus of special deposits as on June 30, 2003 and providing interest payment in cash on net balances.

@ : Includes saving bonds, reserve funds, deposits, postal insurance and life annuity fund and special securities issued to international financial institutions.

indicators of the State Governments are expected to be placed substantially lower than their levels in the previous year (Table 4.22).

4.60 Total revenue receipts as well as States' own revenue constituents would, however, remain broadly unchanged in 2004-05 as ratios to GDP from their levels in the previous year (Table 4.23).

Table 4.22: Major Deficit Indicators of the State Governments

(Rupees crore)

| Item | 2004-05 | 2003-04 | 2003-04 | 2002-03 | 2000-02 | 1995-00 | 1990-95 | Percentage variations | |
|----------------------|-------------------|-------------------|-------------------|-------------------|-----------|-----------|-----------|-----------------------|---------|
| | (BE) | (RE) | (BE) | | (Average) | (Average) | (Average) | Col.2/3 | Col.3/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Gross Fiscal Deficit | 1,12,251 (3.6) | 1,40,407 (5.1) | 1,16,110 (4.2) | 1,02,058 (4.1) | (4.2) | (3.5) | (2.8) | -20.1 | 20.9 |
| Revenue Deficit | 48,259 (1.5) | 72,240 (2.6) | 48,824 (1.8) | 55,173 (2.2) | (2.6) | (1.7) | (0.7) | -33.2 | 48.0 |
| Primary Deficit | 20,604 (0.7) | 56,682 (2.0) | 33,443 (1.2) | 32,092 (1.3) | (1.1) | (1.4) | (1.6) | -63.6 | 69.5 |

RE: Revised Estimates. BE : Budget Estimates.

Note: The figures in parentheses are percentages to GDP.

Table 4.23: Total Receipts of the State Governments

(Rupees crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 2000-02 (Average) | 1995-00 (Average) | 1990-95 (Average) | Percentage variations | |
|---------------------------------|--------------------|--------------------|--------------------|--------------------|----------------------|----------------------|----------------------|-----------------------|---------|
| | | | | | | | | Col.2/3 | Col.3/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Total Receipts (1+2) | 5,42,295 (17.4) | 5,39,635 (19.5) | 4,77,313 (17.4) | 4,23,819 (17.2) | (16.6) | (15.2) | (16.1) | 0.5 | 13.1 |
| 1. Total revenue receipts (a+b) | 3,67,428 (11.8) | 3,27,302 (11.8) | 3,30,688 (12.1) | 2,77,389 (11.2) | (11.3) | (10.9) | (12.1) | 12.3 | -1.0 |
| (a) States own Revenue (i+ii) | 2,30,991 (7.4) | 2,03,114 (7.3) | 2,04,804 (7.5) | 1,76,479 (7.1) | (7.1) | (6.9) | (7.3) | 13.7 | -0.8 |
| i) States own tax | 1,82,982 (5.9) | 1,62,700 (5.9) | 1,64,838 (6.0) | 1,42,006 (5.8) | (5.6) | (5.3) | (5.4) | 12.5 | -1.3 |
| ii) States own non-tax | 48,009 (1.5) | 40,414 (1.5) | 39,966 (1.5) | 34,473 (1.4) | (1.5) | (1.6) | (1.8) | 18.8 | 1.1 |
| (b) Central Transfers (i+ii) | 1,36,437 (4.4) | 1,24,188 (4.5) | 1,25,884 (4.6) | 1,00,910 (4.1) | (4.2) | (4.0) | (4.9) | 9.9 | -1.3 |
| i) Shareable taxes | 77,343 (2.5) | 65,044 (2.3) | 64,049 (2.3) | 56,457 (2.3) | (2.4) | (2.4) | (2.6) | 18.9 | 1.6 |
| ii) Central Grants | 59,094 (1.9) | 59,144 (2.1) | 61,835 (2.3) | 44,453 (1.8) | (1.8) | (1.6) | (2.3) | -0.1 | -4.4 |
| 2. Capital Receipts (a+b) | 1,74,867 (5.6) | 2,12,333 (7.7) | 1,46,625 (5.3) | 1,46,430 (5.9) | (5.3) | (4.2) | (4.0) | -17.6 | 44.8 |
| (a) Loans from Centre@ | 33,852 (1.1) | 32,203 (1.2) | 33,634 (1.2) | 26,348 (1.1) | (1.0) | (1.0) | (1.2) | 5.1 | -4.3 |
| (b) Other Capital Receipts | 1,41,015 (4.5) | 1,80,130 (6.5) | 1,12,991 (4.1) | 1,20,082 (4.9) | (4.3) | (3.2) | (2.9) | -21.7 | 59.4 |

BE : Budget Estimates.

RE: Revised Estimates.

@ : With the change in the system of accounting with effect from 1999-2000, States' share in small savings, which was earlier included under loans from the Centre, is now included under internal debt and shown as special securities issued to the National Small Saving Fund (NSSF) of the Central Government. The data for the years prior to 1999-2000 as reported in this table, however, exclude loans against small savings for the purpose of comparison.

Note : Figures in parentheses are percentages to GDP.

4.61 Capital outlay would be compressed in 2004-05 but would remain higher as a ratio to GDP than the level in the 1990s. Developmental expenditure is budgeted to decline, while there would be no let-up in the increase

in non-developmental expenditure. Consequently, while the ratio of developmental expenditure to GDP would decline in 2004-05, the non-developmental expenditure-GDP ratio would remain stable (Table 4.24).

Table 4.24: Expenditure Pattern of the State Governments

(Rupees Crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 2000-02 (Average) | 1995-00 (Average) | 1990-95 (Average) | Percentage variations | |
|--------------------------------|--------------------|--------------------|--------------------|--------------------|----------------------|----------------------|----------------------|-----------------------|---------|
| | | | | | | | | Col.2/3 | Col.3/4 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Total Expenditure (1+2 =3+4+5) | 5,42,824 (17.4) | 5,51,956 (19.9) | 4,84,552 (17.7) | 4,19,450 (17.0) | (16.6) | (15.3) | (16.0) | -1.7 | 13.9 |
| 1. Revenue Expenditure | 4,15,687 (13.3) | 3,99,541 (14.4) | 3,79,513 (13.8) | 3,32,563 (13.5) | (13.9) | (12.6) | (12.8) | 4.0 | 5.3 |
| of which : | | | | | | | | | |
| Interest payments | 91,648 (2.9) | 83,724 (3.0) | 82,667 (3.0) | 69,966 (2.8) | (2.6) | (2.0) | (1.7) | 9.5 | 1.3 |
| 2. Capital Expenditure | 1,27,137 (4.1) | 1,52,415 (5.5) | 1,05,039 (3.8) | 86,887 (3.5) | (2.7) | (2.7) | (3.2) | -16.6 | 45.1 |
| of which : | | | | | | | | | |
| Capital outlay | 56,629 (1.8) | 60,751 (2.2) | 55,160 (2.0) | 36,209 (1.5) | (1.5) | (1.4) | (1.6) | -6.8 | 10.1 |
| 3. Development Expenditure | 2,80,823 (9.0) | 2,99,357 (10.8) | 2,67,030 (9.7) | 2,27,034 (9.2) | (9.8) | (9.6) | (10.8) | -6.2 | 12.1 |
| 4. Non-Development Expenditure | 1,99,065 (6.4) | 1,76,821 (6.4) | 1,76,009 (6.4) | 1,50,264 (6.1) | (5.9) | (4.9) | (4.3) | 12.6 | 0.5 |
| 5. Others | 62,936 (2.0) | 75,778 (2.7) | 41,513 (1.5) | 42,152 (1.7) | (0.9) | (0.7) | (0.9) | -16.9 | 82.5 |

BE : Budget Estimates.

RE : Revised Estimates.

Note : Figures in parentheses are percentages to GDP.

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Table 4.25: Decomposition and Financing Pattern of Gross Fiscal Deficit of the States

(Per cent)

| Item | 2004-05 (BE) | 2003-04 (RE) | 2003-04 (BE) | 2002-03 | 2000-02 (Average) | 1995-00 (Average) | 1990-95 (Average) |
|--|-----------------|-----------------|-----------------|---------|----------------------|----------------------|----------------------|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Decomposition (1+2+3) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1. Revenue Deficit | 43.0 | 51.5 | 42.1 | 54.0 | 60.7 | 44.7 | 24.7 |
| 2. Capital Outlay | 50.4 | 43.3 | 47.5 | 35.5 | 34.2 | 43.2 | 55.3 |
| 3. Net Lending | 6.6 | 5.2 | 10.4 | 10.5 | 5.1 | 12.1 | 20.0 |
| Financing (1+2+3+4+5) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1. Special Securities issued to the NSSF | 53.5 | 41.6 | 43.2 | 49.7 | 36.8 | 5.8 | – |
| 2. Market Borrowings | 23.0 | 32.1 | 14.5 | 27.9 | 16.0 | 16.1 | 16.0 |
| 3. State Provident Fund | 10.9 | 8.2 | 9.3 | 9.6 | 10.2 | 13.4 | 14.3 |
| 4. Loans from the Centre | -6.5 | -15.1 | 6.7 | -1.8 | 13.5 | 40.6 | 49.0 |
| 5. Others | 19.1 | 33.2 | 26.3 | 14.6 | 23.6 | 24.0 | 20.7 |

BE : Budget Estimates. RE : Revised Estimates. – : Not applicable.

4.62 Small savings are expected to continue to be the major source of financing of the States' GFD in 2004-05. The shares of market borrowings and 'others' including loans from banks and financial institutions are budgeted to decline in 2004-05 from the revised estimates of 2003-04 (Table 4.25).

4.63 To sum up, while the State budgets for 2004-05 seek to carry forward the reform process initiated in the recent past, it is evident that the structural weaknesses in their finances continue to circumscribe resource allocation towards developmental ends. A renewed emphasis on fiscal empowerment coupled with progressive adoption of

fiscal responsibility legislation by all the State Governments could expedite the attainment of developmental goals.

Combined Budgets for 2004-05

4.64 The continued efforts towards fiscal consolidation were reflected in the lower projections for the combined gross fiscal deficit, the revenue deficit and the primary deficit in 2004-05 as compared with the revised estimates for 2003-04 (Table 4.26)³. This reduction is sought to be achieved through an acceleration in tax collections and a moderation in the growth of aggregate expenditure.

Table 4.26: Measures of Deficit - Central and the State Governments

| Year | (Rupees crore) | | | (Per cent to GDP) | | |
|------------|----------------------|-----------------|-----------------|----------------------|-----------------|-----------------|
| | Gross Fiscal Deficit | Revenue Deficit | Primary Deficit | Gross Fiscal Deficit | Revenue Deficit | Primary Deficit |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 1990-91 | 53,580 | 23,871 | 28,585 | 9.4 | 4.2 | 5.0 |
| 1995-96 | 77,671 | 37,932 | 18,598 | 6.54 | 3.2 | 1.6 |
| 1996-97 | 87,244 | 48,768 | 17,156 | 6.38 | 3.6 | 1.3 |
| 1997-98 | 1,10,743 | 62,782 | 32,466 | 7.3 | 4.1 | 2.1 |
| 1998-99 | 1,57,053 | 1,10,618 | 63,956 | 9.0 | 6.4 | 3.7 |
| 1999-2000 | 1,84,826 | 1,21,393 | 74,375 | 9.5 | 6.3 | 3.8 |
| 2000-01 | 1,99,852 | 1,38,803 | 75,035 | 9.5 | 6.6 | 3.6 |
| 2001-02 | 2,26,418 | 1,59,395 | 84,048 | 9.9 | 7.0 | 3.7 |
| 2002-03 | 2,34,923 | 1,63,052 | 76,475 | 9.5 | 6.6 | 3.1 |
| 2003-04 BE | 2,59,200 | 1,61,116 | 83,333 | 9.4 | 5.9 | 3.0 |
| 2003-04 RE | 2,60,217 | 1,72,100 | 80,214 | 9.4 | 6.2 | 2.9 |
| 2004-05 BE | 2,46,345 | 1,24,430 | 54,637 | 7.9 | 4.0 | 1.7 |

BE : Budget Estimates. RE: Revised Estimates.

³ Data in respect of State Budgets are provisional.

Table 4.27: Combined Receipts and Disbursements of the Centre and the States

(Rupees crore)

| Item | 2004-05 (BE) | 2003-04 (RE) | Variation (Col. 2/Col.3) | |
|---|----------------------------------|----------------------------------|--------------------------|------------|
| | | | Absolute | Per cent |
| 1 | 2 | 3 | 4 | 5 |
| I. Total Receipts (A+B) | 8,98,290 (28.8) | 8,72,973 (31.5) | 25,317 | 2.9 |
| A. Revenue Receipts (1+2) | 6,05,401 | 5,29,248 | 76,153 | 14.4 |
| 1. Tax Receipts | 4,94,232 | 4,15,283 | 78,949 | 19.0 |
| a) Direct Taxes | 1,57,454 | 1,21,970 | 35,484 | 29.1 |
| b) Indirect Taxes | 3,36,777 | 2,93,313 | 43,464 | 14.8 |
| 2. Non-tax receipts | 1,11,169 | 1,13,965 | -2,796 | -2.5 |
| B. Capital Receipts | 2,92,889 | 3,43,725 | -50,836 | -14.8 |
| II. Total Disbursements (A+B) | 8,98,819 (28.8) | 8,85,293 (31.9) | 13,526 | 1.5 |
| A. Developmental Expenditure | 4,28,266 | 4,39,465 | -11,199 | -2.5 |
| B. Non-Developmental Expenditure (Including others) | 4,70,553 | 4,45,827 | 24,726 | 5.5 |

BE : Budget Estimates. RE: Revised Estimates.
Note: Figures in parentheses are percentages to GDP.

4.65 Combined revenue receipts are budgeted to register a substantial growth during 2004-05, solely on account of a rise in tax collections. The combined tax-GDP ratio of the Centre and the States is, accordingly, anticipated to register an improvement of 0.8 percentage points of GDP during 2004-05. The non-tax revenue, on the other hand, is budgeted to decline over the revised estimates for 2003-04. On

the expenditure side, the share of non-developmental expenditure is budgeted to be higher than in the revised estimates for 2003-04 (Table 4.27).

4.66 Of the combined gross fiscal deficit, 47.2 per cent is budgeted to be financed through market borrowings. The share of small savings is budgeted to decline. The share of external financing will be relatively insignificant (Table 4.28).

Table 4.28: Financing of Gross Fiscal Deficit of the Centre and the States

(Rupees crore)

| Year | Market Borrowings (Net) | State Provident Fund | Small Savings | External Borrowings | Others | Gross Fiscal Deficit |
|------------|-------------------------|----------------------|-------------------|---------------------|------------------|----------------------|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 2002-03 | 1,32,587 (56.4) | 11,654 (5.0) | 52,261 (22.2) | -11,934 (-5.0) | 50,355 (21.4) | 2,34,923 (100.0) |
| 2003-04 BE | 1,24,034 (47.8) | 14,696 (5.7) | 60,000 (23.1) | 3,582 (1.4) | 56,888 (21.9) | 2,59,200 (100.0) |
| 2003-04 RE | 1,30,745 (50.2) | 13,977 (5.4) | 124,900 (48.0) | -11,705 (-4.6) | 2,300 (0.9) | 2,60,217 (100.0) |
| 2004-05 BE | 1,16,170 (47.2) | 12,991 (5.3) | 71,800 (29.1) | 8,076 (3.2) | 37,308 (15.1) | 2,46,345 (100.0) |

RE : Revised Estimates. BE : Budget Estimates.
Note: Figures in parentheses are percentages to GFD.

Outlook

4.67 The policy objectives for 2004-05 are to build upon the fiscal consolidation, *albeit* modest, achieved in 2003-04. The deepening of tax reforms, reorienting expenditure towards thrust areas and enhancing investment should help in attaining the goals set under the FRBM Act, 2003. The commitment to eliminate the revenue deficit as stipulated by the FRBM Act, 2003 and generation of revenue surplus for further investment is consistent with the envisaged improvement in the tax-GDP ratio. In this context, the focus is on expanding scope of the services tax by bringing newer services within the purview of taxation. On the expenditure front, non-plan expenditure is sought to be pruned by plugging leakages and by targeting subsidies at the needy. Public investments in infrastructure, both economic and social, are to be stepped up with an improved mechanism for delivery of infrastructural services. The Centre may be able to continue with the policy of managing the debt prudently through the debt-swap scheme and

refinancing to reduce the interest burden. The FRBM Rules, 2004 would facilitate the reduction of total liabilities of the Centre.

4.68 At the States' level, the emerging fiscal scenario, as reflected in the revised estimates for 2003-04, indicates the persistence of structural infirmities, *albeit* with some improvement in the orientation of expenditure. A renewed emphasis on fiscal empowerment is reflected in the major policy initiatives contained in the State Budgets for 2004-05. These include perseverance with fiscal reforms, revenue augmentation and expenditure containment, reforms in tax administration, improvement in recovery of user charges, restructuring of SPSUs, enhancing transparency in budgetary operations, emphasis on infrastructure development and reduction and management of States' debt. The debt swap scheme and availing of loans from external agencies on the same terms and conditions as the Centre would reduce the debt burden of the States.